

Handbook of Cost Plan Procedures for California Counties



STEVE WESTLY

California State Controller

Contents

INTRODUCTION.....	3
 PART I: DEVELOPMENT, APPROVAL, AND USE OF A COUNTYWIDE COST PLAN	
Table of Contents.....	5
Section	
1100: Responsibility for Cost Plans	7
1200: Cost Plan Developmental Concepts	11
1300: Cost Plan Approval Process	15
1400: County Cost Plan Preparation	35
1500: Audits	39
 PART II: PREPARATION REQUIREMENTS FOR COST PLANS	
Table of Contents.....	43
Section	
2100: Acceptable Cost Allocation Plans	45
2200: Costs, Revenues, Reimbursements, and Other Credits	51
2300: Allowable Compensation for Personnel Services	63
2400: Allowable and Allocable Support Service and External Overhead Costs.....	68
2500: Depreciation and Use Allowances	73
2600: Electronic Data Processing – Grant Agency Approval	75

PART III: GUIDELINES FOR GRANT REIMBURSEMENT OF SPACE COSTS

Table of Contents.....	77
Section	
3100: Purpose and Intent.....	79
3200: Characteristics of County-Owned Facilities	83
3300: Characteristics of County-Leased Facilities	89
3400: Interest	93
3500: Space Costs Approval	98

PART IV: GUIDELINES FOR GRANT REIMBURSEMENT OF SELF-INSURANCE PROGRAM COSTS

Table of Contents.....	107
Section	
4100: Insurance Costs	109
4200: Risk Management	113
4300: Accounting for Self-Insurance Programs.....	120
4400: Requirements for Grant Reimbursement of Insurance Costs.....	123
HANDBOOK REVISION REQUEST	131

Introduction

The State Controller's Office has developed this handbook to assist California counties in the understanding and application of the cost principles established by the federal Office of Management and Budget Circular A-87 (OMB A-87) for state, local, and federally-recognized Indian tribal governments. This handbook contains the latest policies and procedures for the preparation and application of countywide cost allocation plans. It is intended to be used in conjunction with OMB A-87 and Assistant Secretary Management and Budget Cost Principles and Agreements with the Federal Government (ASMB C-10), issued by the Department of Health and Human Services.

Federal costing principles are intended to apply to the fifty states and to thousands of local governmental jurisdictions across the country. Consequently, the cost principles promulgated by OMB A-87 are designed to be generally applicable to all government units that receive grants and/or cost reimbursements or have contracts with the federal government.

This handbook was developed using reason and logic in interpreting federal cost principles, considering the answers to the following two questions as the overriding theme in all cost plan matters:

- Do the total costs accumulated for a service department reasonably reflect the value of services provided by that department?
- Do costs that are distributed and/or billed to each operating department equitably reflect the value of the services received by these departments?

This handbook is divided into four parts: Part I, Development, Approval, and Use of a Countywide Cost Plan; Part II, Preparation Requirements for Cost Plans; Part III, Guidelines for Grant Reimbursement of Space Costs; and Part IV, Guidelines for Grant Reimbursement of Self-Insurance Program Costs. Each part of this handbook is preceded by a separate table of contents and consists of several sections, exhibits, sample forms, and glossaries.

The State Controller's Office desires to work closely with counties on any cost plan issues, questions, and concerns. Comments and suggestions are welcome and a form is included at the back of this handbook that may be used when formulating written correspondence. Please feel free to contact your county's assigned cost plan analyst at any time or write directly to the:

Cost Plans and Local Apportionments Section
Division of Accounting and Reporting
P.O. Box 942850
Sacramento, CA 94250

Part I: Development, Approval, and Use of a Countywide Cost Plan

Section

1100:	Responsibility for Cost Plans	7
1110:	Cognizant Agency Concept.....	7
1120:	Assignment of Cognizant Agencies	7
1130:	Delegation of Cognizant Authority	8
1140:	Cognizance for State Agency Purposes	8
1150:	Approval of Cost Plans	8
1160:	Cost Plans Submittal Timeframe	9
1170:	Estimated (Fixed) Cost Plans	9
1180:	Requesting a Deadline Extension.....	10
1190:	Failure to Submit Cost Plan	10
1195:	Where to Submit Countywide Cost Plans	10
1200:	Cost Plan Developmental Concepts	11
1210:	Direct Costs Defined	11
1220:	Indirect Costs Defined.....	11
1230:	Central Support Services Costs Defined	11
1240:	Cost Plan Defined	12
1250:	Cost Summary/Exhibit and Accounting System Interface.....	12
1260:	Use of Cost Summary/Exhibit	13
Exhibit 1201:	Cost Summary/Exhibit.....	14
1300:	Cost Plan Approval Process	15
1305:	Supplemental Information Checklist.....	15
1310:	Elements of the Desk Review	15
1315:	Field Review	16
1320:	Review Letter	16
1325:	Timetable for Response to Review Letter	17
1330:	Protest Procedures	17
1335:	The Determination	18
1340:	Adjustments to Prior-Year Cost Plans	18
1345:	The Appeal Process	19
1350:	Cost Plan Adjustments	19
1355:	Types of Approvals	19

1360:	Formal Approval	19
1365:	Reliance upon Formal Approval	20
1370:	Changes to Formally Approved Cost Plans	20
1375:	Provisional Approvals	20
1380:	Approval Methodology	20
1385:	Fixed (Estimated) with Carry-Forward	20
1390:	Indirect Cost Claiming: Amounts vs. Rates	21
1395:	Examples of Approvals	21
Exhibit 1301:	Negotiation Agreement, Countywide Cost Allocation Plan	23
Exhibit 1302:	Provisional Approval, Countywide Cost Allocation Plan	26
Exhibit 1303:	Supplemental Information Checklist	29
Exhibit 1304:	Cost Plan Review Process	34
1400:	County Cost Plan Preparation	35
1410:	Cost Plan Coordinator	35
1420:	Cost Plan Certification	35
1430:	Grants Management Coordinator	35
1440:	Grantee Departments' Use of Cost Plan	36
1450:	Indirect Costs Used as Matching Share	36
1460:	Non-Grantee Departments' Use of Cost Plan	36
1470:	Full Costing Plan	37
Exhibit 1401:	Certification of Cost Allocation Plan	38
1500:	Audits	39
1510:	Audit of Formally Approved Plans	39
1520:	The Protest	39
1530:	The Determination	39
1540:	Program Audits	40
1550:	The Single Audit Act	40

Section 1100: Responsibility for Cost Plans

The current federal Office of Management and Budget Circular A-87 (OMB A-87) is titled *Cost Principles for State, Local and Indian Tribal Governments*. It establishes principles for determining the allowable reimbursable costs incurred by state, local, and federally recognized Indian tribal entities, generally referred to as government units, under contracts, cost reimbursement contracts, and other agreements with the federal government (collectively referred to in OMB A-87 as “federal awards”). All federal agencies apply the principles in OMB A-87 in determining reimbursable costs incurred by government units under federal awards and subawards. OMB A-87 is available at <http://www.whitehouse.gov/omb/>

1110: Cognizant Agency Concept

The term “cognizant agency” as used in OMB A-87 refers to any agency that is responsible for reviewing, negotiating, and approving, on behalf of all federal agencies, cost allocation plans or indirect cost proposals developed under OMB A-87. OMB designates cognizant agencies.

Under OMB A-87, the federal Department of Health and Human Services (DHHS) has cognizance for negotiated statewide cost allocation plans for all 50 states, the District of Columbia, and Puerto Rico.

In discharging its responsibilities as a principal cognizant agency, DHHS’ Office of Audit Resolution and Cost Policy, in the Office of Grants and Acquisition Management, developed brochure ASMB C-10, *Cost Principles and Procedures for Developing Cost Allocation Plans and Indirect Cost Rates for Agreements with the Federal Government*. This brochure describes in general terms the process of indirect cost determination, including guidance on the preparation and submission of cost allocation proposals by state and local governments. Copies of this brochure are available for sale from the U.S. Government Printing Office, Superintendent of Documents, Mail Stop SSOP, Washington, DC, 20402-9328. ASMB C-10 and OMB A-87 may be accessed at DHHS’ Office of Audit Resolution and Cost Policy - <http://www.hhs.gov/ogam/oarc/policy/index.html>

1120: Assignment of Cognizant Agencies

OMB published in the *Federal Register* a list of agencies assigned cognizance for single audits and for cost allocation under OMB A-87. This list identifies agencies assigned cognizance to all 50 states as well as to many of the larger local governmental entities across the nation.

OMB has designated DHHS as the agency assigned cognizance for the State of California's Statewide Cost Allocation Plan; it has also assigned cognizance to DHHS for the countywide cost allocation plans of all 58 California counties. The cognizance for some specific county programs and for the major municipalities has been divided among various federal departments, including the Department of Labor (DOL), the Department of Housing and Urban Development (HUD), the Environmental Protection Agency (EPA), the Department of Agriculture (USDA), and DHHS.

The agency-assigned cognizance of a particular local entity can change. Any city or local (other than county) government having questions on

cognizance should contact the federal department having the major dollar involvement in the entity's programs or the Financial Management Division, OMB, Washington, DC, 20503, telephone (202) 395-3993 (<http://www.whitehouse.gov/OMB>).

1130: Delegation of Cognizant Authority

DHHS may delegate to a state the responsibility of approving local government cost allocation plans. When a state is assigned delegated cognizance, it becomes the authorized representative of DHHS and can review, negotiate, and approve local government cost allocation plans on behalf of that agency.

In December 1971, DHHS delegated cognizance authority for California counties to the Director of the California State Department of Social Welfare (DSS). In January 1974, DHHS re-delegated this authority to the California State Controller's Office, where it has remained. Inherent in this delegation is authority to review, negotiate, and approve countywide cost allocation plans for California counties in accordance with OMB A-87. This delegation of authority includes the responsibility to develop and disseminate information to supplement existing cost plan instructions as well as the authority to review and approve procedures and methodologies used by counties for direct billing of central services. This authority does not include the responsibility for approving indirect cost rate proposals (ICRPs) of county departments.

The State of California, under its delegated cognizance, acts on behalf of DHHS in cost plan matters. As the agency assigned cognizance for California counties, the State Controller has the authority to modify, expand, or reduce OMB A-87 documentation requirements and to request additional information related to submitted county cost plans.

1140: Cognizance for State Agency Purposes

At this time there is no agency designated to act as the cognizant agency for all state grants and contracts. Currently, any state department reimbursing counties with federal flow-through funds must recognize and accept the countywide cost allocation plan as approved by the Controller's Office. In most cases these departments accept the same plan for identifying and reimbursing the costs associated with the State's share of the federally funded program. In some instances, state departments that have no federal flow-through funds also accept the cost plan for indirect cost reimbursement purposes.

Some state departments do not recognize costs approved by the Controller's Office when reimbursing indirect costs related to their programs. Until the State Legislature passes, or the Governor's Office issues, a resolution decreeing that all state agency secretaries will direct their departments to accept countywide cost allocation plans as approved by the Controller's Office for indirect cost reimbursement, this office does not have cognizance in this area.

1150: Approval of Cost Plans

Countywide cost allocation plans have been submitted for review and approval by the State Controller's Office since July 1, 1974. Since this time, each California county has been required to have received from the State

Controller either a provisionally or a formally approved countywide cost allocation plan before any indirect costs or direct billings for central support services may be reimbursed by state and federal agencies.

All cost plans submitted by counties to be used as fixed (estimated) costs of the forthcoming fiscal year must be based upon the final (actual) costs of the fiscal year just completed. Any deviation from this procedure must be specifically approved by the Controller's Office. Increasing these final costs to cover projected inflationary trends is not allowed.

1160: Cost Plans Submittal Timeframe

Cost plans must be submitted to the State Controller at least six months prior to the fiscal year for which the plans are to be used. For example, cost plans for fiscal year 1999-2000 used, as estimated costs, actual costs of the 1997-98 fiscal year and were required to be submitted to the State Controller no later than December 31, 1998 (six months before the date the plans became effective).

1170: Estimated (Fixed) Cost Plans

Any county wishing to submit a separate estimated (fixed) cost plan for use in a forthcoming fiscal year must be aware of the following requirements.

1. The application of across-the-board inflation factors is not to be allowed in the preparation of estimated (fixed) cost plans used for claiming.
2. The use of separate estimated (fixed) cost plans for use in claiming is allowed, provided the county has received prior written approval for the use of this type of plan from the State Controller.
3. Estimated (fixed) cost plans are due to the State Controller six months prior to the start of the fiscal year in which they are to be used, unless an extension is received in writing from the Controller's Office, as described in Section 1180 of this handbook.
4. When a separate estimated (fixed) cost plan is prepared, the county may use the appropriations adopted by the county board of supervisors in the final budget adopted and approved for use in the current fiscal year. Any salary and wage increases for the fiscal year in which the plan will be used may be added to these appropriations if the increases have been approved and adopted by the board of supervisors.
5. If the county wishes to add salary and wage increases to its estimated (fixed) cost plan, it must describe its intention to do so in its letter to the State Controller's Office requesting the use of a separate estimated plan. Minutes of the board of supervisors meeting that support the amounts of any planned increases must be provided.
6. If the use of a separate estimated (fixed) cost plan is approved, an actual (final) cost plan must be prepared and submitted to the State Controller's Office within six months of the close of the actual fiscal year of use. Any differences between the estimated and actual costs will be carried forward into a cost plan used in a future year.

For example, a county could have used the approved and adopted appropriations of the 1998-99 fiscal year as an estimate for the 1999-2000 fiscal year. This estimate could have been increased by the amounts of any negotiated salary and wage increase taking place in the 1999-2000 fiscal year as long as this increase had been approved and adopted by the board of supervisors prior to the county's completion of the estimated fiscal year 1999-2000 cost plan. Actual costs for fiscal year 1999-2000 would have been due to the State Controller's Office not later than December 31, 2000.

**1180: Requesting a
Deadline Extension**

If a cost plan cannot be submitted to the State Controller by December 31 of the year prior to the fiscal year for which it is to be used, a written request for a deadline extension must be forwarded to State Controller's Office. This written request must be received by the State Controller at least 30 days before the December 31 submittal deadline, and it must state the reasons why the plan cannot be submitted by the deadline. If the stated reasons are acceptable, an extension of the deadline will be approved in writing. If a request for an extension of the deadline is not in writing, or if the justifications for the extension are not reasonable, no extension will be granted.

Timely preparation of the countywide cost plan ensures that reliable cost information will be available for use in budget preparation. It provides cost information that is necessary for the preparation of departmental indirect cost proposals, and it ensures that there will be no delay in the payment of claims submitted by county departments for reimbursable costs.

**1190: Failure to Submit
Cost Plan**

If, at the beginning of a fiscal year, a county has not submitted and received approval for its cost plan for that year, there will be no basis for federal and state reimbursement of indirect costs. The negotiation agreement by which a cost plan is approved also serves as the authorization for reimbursement of direct charges for central support services. The absence of an approved cost plan precludes a county from receiving federal and state reimbursement for support services already charged to grantee departments through the use of direct charges.

**1195: Where to Submit
Countywide Cost Plans**

All countywide cost plans must be submitted to the State Controller's Office for approval prior to use. The mailing address is:

County Cost Plans and Local Apportionments Section
Division of Accounting and Reporting
State Controller's Office
P.O. Box 942850
Sacramento, CA 94250

Section 1200: Cost Plan Development Concepts

There are basically three types of costs that are experienced by any department in conducting its operations: direct costs, indirect costs, and central support service costs. A first step in developing a cost allocation plan is to examine the interrelationships between the various county departments in terms of these types of costs.

1210: Direct Costs Defined

A direct cost, as defined in OMB A-87, is a cost that can be identified specifically with a particular final cost objective. OMB A-87 notes that typical direct costs chargeable to federal awards are:

1. Compensation (salaries and benefits) of employees for the time devoted and identified specifically to the performance of federal awards;
2. Cost of materials and services acquired, consumed, or expended specifically for the purpose of those awards;
3. Equipment and other approved capital expenditures; and
4. Travel expenses incurred specifically to carry out the award.

A grantee department may receive a service furnished specifically for a particular grant function from another department. The allowable direct costs associated with the department providing this service, plus a proportionate share of the allowable supporting costs and supervision directly related to the service, would be considered direct costs of the grantee department.

1220: Indirect Costs Defined

OMB A-87, Attachment A, Section F, defines indirect costs as those costs that are:

1. Incurred for a common or joint purpose; or
2. Not readily assignable to the cost objectives specifically benefited without effort disproportionate to the results achieved.

This same section notes that the term "indirect costs" used in the circular applies to costs of this type originating in the grantee department, as well as those incurred by other departments in supplying goods, services, and facilities, and states:

To facilitate equitable distribution of indirect expenses to the cost objectives served it may be necessary to establish a number of pools of indirect costs within a governmental unit department or in other agencies providing services to a governmental unit department. Indirect cost pools should be distributed to benefited cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.

1230: Central Support Services Costs Defined

All county departments may receive "central support services" from other county departments. OMB A-87 addresses billed central support services and allocated central support services. OMB A-87, Attachment C, Section B, provides the following definitions.

1. “Billed central support services” means central support services that are billed to benefited agencies and/or programs on an individual fee-for-service or a similar basis. Typical examples of billed services include computer services, transportation services, insurance, and fringe benefits.
2. “Allocated central support services” means central support services that benefit operating agencies but are not billed to the agencies on a fee-for-service or similar basis. These costs are allocated to benefited agencies on some reasonable basis. Examples of such services might include general accounting, personnel administration, purchasing, and similar activities and support functions necessary to sustain the direct effort involved in administering a grant program or an activity providing service to the grant program.

The examples of “central support services” provided are not all-inclusive and should not be construed to preclude other functions from being considered as an indirect or central support service. Ordinarily the functions mentioned above would be centralized in a department or budget unit outside of the grantee department's organization structure.

1240: Cost Plan Defined

Before indirect costs and central support service charges may be claimed for reimbursement by a grantee department, there must be some formal means of accumulating and identifying these types of costs to all benefiting departments. Regardless of whether or not a county has a formal, comprehensive cost accounting system, the best method of accumulating and identifying indirect costs and any use allowances is a cost allocation plan prepared in accordance with the cost principles set forth in OMB A-87, ASMB C-10, and this handbook.

A cost plan identifies and assigns central support service costs to benefited agencies by a reasonable and consistent basis. All costs and other data used to distribute the costs included in a cost allocation plan must be supported by formal accounting records and other data that will corroborate the propriety and accuracy of costs assigned to federal awards. The central support service cost allocation plan contains the documentation identifying, accumulating, and distributing allowable costs to operating departments, including grantee departments, together with the allocation methods used.

1250: Cost Summary/ Exhibit and Accounting System Interface

When the cost plan format is utilized for identification of indirect and central support service costs associated with the various operating and grantee departments, the resulting product will be a cost summary or cost exhibit. These two terms are synonymous and may be used interchangeably. A cost exhibit or cost summary identifies the unbilled portion of indirect costs to the departments that will receive services from the departments whose costs are included in the plan in the fiscal year that the plan addresses. Adjustments, corrections, and other cost considerations that affect prior years can also be included on this exhibit.

The accounting system of the agency preparing a cost plan must be able to track the actual cost information that occurs during each fiscal year. This is necessary so that the actual costs can be determined at a later date and any required adjustments made to cost plan expenditure allocations in subsequent cost plans.

If a local government utilizes a formal cost accounting system, the direct costs accounted for by that system should be reported in a manner that reflects the cost principles set forth in OMB A-87, ASMB C-10, and this handbook. This procedure is intended to ensure that the resulting identification of costs to all operating departments will be in accordance with federal cost reimbursement principles.

1260: Use of Cost Summary/Exhibit

Any claims made by a grantee department for indirect costs should be based upon the cost summary/exhibit. The cost summary/exhibit provides a basis for charging users of county central support services, including services to outside agencies—for example, auditing services provided by a county-auditor controller to a special district. Claims for reimbursement must include a review of direct charges to the grantee departments in the county's accounting system in order to avoid a situation in which a cost is considered as an indirect cost allocated in the cost plan as well as a direct cost.

01/01/2000

Schedule A

Summary Page 7

COUNTY, CALIFORNIA
OMB A-87 COST ALLOCATION
 Allocated Costs by Department

Central Service Departments	392100 Social Svc	99999 All Other	Subtotal	Direct Billed	Unallocated	Total
000001 Building Use	47,586	47,602	748,440			748,440
000002 Equip Use			541,459			541,459
120000 Auditor	210,451	119,611	2,052,742	87,169	(130,516)	2,009,395
180000 CAO	236,970	127,714	1,761,188	30,324	(30,324)	1,761,188
240000 Co Counsel	211,008	64,241	806,624	863,502	(863,502)	806,624
303000 Comm Tech	5,024	102,173	925,643	1,134,360	(975,598)	1,084,405
331000 General Services	4,314		18,573	416,063	(415,996)	18,640
333000 Fac Mgmt	50,587	136,028	1,819,460	1,593,812	(1,593,812)	1,819,460
334100 Purchasing	27,257	7,664	387,123			387,123
334200 Stores	3,670	948	19,936	199,051	(199,051)	19,936
490000 Parks & Rec	35,595	10,140	289,634		2,529,877	2,819,511
510000 Personnel	81,573	56,619	883,205			883,205
515202 General Ins	6,718		410,760			410,760
730000 Treasurer	88,519		572,006		216,011	788,017
Total Allocated	1,009,272	672,740	11,236,793	4,324,281	(1,462,911)	14,098,163
Carry-Forward	219,007	(109,447)	1,064,975			1,064,975
Costs with Carry-Forward Adjustments	1,228,279	563,293	12,301,768 (413,610)	4,324,281	(1,462,911)	15,163,138 (413,610)
Proposed Costs	1,228,279	563,293	11,888,158	4,324,281	(1,462,911)	14,749,528

Exhibit 1201
Cost Summary/Exhibit

Section 1300: Cost Plan Approval Process

The State Controller has established a formal procedure for consistent review of countywide cost allocation plans. This procedure consists of a combination of both desk and field reviews performed by assigned analysts in the State Controller's Office.

1305: Supplemental Information Checklist

A desk review of a county's cost allocation plan will not begin until a supplemental checklist (see Exhibit 1303, pages 29-33) and all other required supporting information have been received by the County Cost Plans Section. In order to make sure that the cost plan was prepared adequately and that all necessary supporting documents were submitted, this checklist must be completed and certified by the appropriate individuals. Any items in the checklist that are answered in the negative must be fully explained in the Comments section at the end of the checklist.

1310: Elements of the Desk Review

When a plan is received by the State Controller's Office, it is assigned to an analyst, who is responsible for the review, negotiation, and approval of the plan. Before any type of approval is issued, the plan will be subjected to a comprehensive "desk review" procedure. Prior to beginning this review, the assigned analyst will perform a preliminary examination of each plan to ensure that:

1. The plan was received in accordance with the submission deadline; and
2. The information listed on the Supplemental Information Checklist has been submitted (see Section 1305 and Exhibit 1303, pages 29-33).

The desk review process includes, but is not limited to, the following processes.

1. Cost plan narratives are reviewed to ensure that they fully explain the development of each allowable cost (see Section 2160, Narratives, page 48).
2. The plan is compared to the financial statements containing the actual costs upon which it was based. If the costs shown in the plan do not agree with the financial statements, the county must prepare and include a reconciliation schedule explaining any differences.
3. The allocation methodology and statistics are examined to ensure that proper cost principles and procedures, as outlined in OMB A-87, Publication ASMB C-10, and this handbook, have been adhered to.
4. All revenues and other financing sources (e.g., interfund and intrafund) generated by, or imputed to, each central support department are reviewed to ensure that they have been properly applied to the appropriate expenditures. These financing resources, if not identifiable to a particular operating department, are applied before allocation (off-the-top). If identifiable to one or more specific departments, they are applied as a part of the allocation process (direct billed).

Further analysis will be undertaken to ensure that:

1. Each schedule, and the plan in its entirety, are mathematically correct;
2. Inter-schedule postings are properly carried forward;
3. The carry-forward adjustments have been correctly computed (see Section 1385, page 20); and
4. The cost summary/exhibit was properly prepared and is presentable for distribution and use.

1315: Field Review

Routinely, or when deemed necessary as a result of the desk review process, the analyst will contact the appropriate county official(s) in order to schedule and perform a “field review.” The purpose of this type of review is to:

1. Verify the information supporting the cost plan and resolve any questions that were noted in the desk review process;
2. Examine financial and statistical information and other supporting documentation used to prepare the cost plan in order to verify that the information is complete and accurate and that the plan, as presented, is both reasonable and equitable;
3. Review billing methods; and
4. Note and record any significant changes to the county government and its accounting procedures.

1320: Review Letter

After completing a desk review or a combination of a desk and a field review, the analyst will summarize, in a review letter or a report to the county, all review findings and any questions that have not been resolved. If there has been only a desk review, a letter will be used. If there has been a desk review and a field review, a report will be sent.

1. If an item of cost is not questioned, it will be considered, based on the information available to the analyst, acceptable as currently presented.
2. Financial costs and/or statistical data may be identified that do not accurately reflect the county's actual experience. If the analyst believes that the resulting allocations are not materially inaccurate enough to warrant a revision of the cost center, these items will be described and the county advised that any associated procedural deficiencies must be corrected in future years.
3. Any financial costs and/or statistical data that are materially inaccurate enough to warrant a revision of the cost center will be described.

Based upon the desk review, or the desk and the field review, the county's review letter (or report) will contain one of the following overall decisions:

1. The cost plan is acceptable as submitted and approved as prepared;
2. The cost plan is acceptable as submitted and approved, with non-material findings noted (a response to the findings is normally required); or

3. The cost plan is not acceptable as submitted because of specifically identified deficiencies. The cost plan must be revised to correct the noted deficient areas before any type of approval will be issued.

1325: Timetable for Response to Review Letter

Should the State Controller determine that plan revisions or modifications to county practices and/or procedures are required, the county must respond to the State Controller's review letter within the following timelines.

1. California counties must respond to the State Controller's Office review letter within 30 days of the letter's receipt. The response must address each finding and recommendation and include a proposed solution to correct any identified deficiencies.

After it determines a county's solutions to be acceptable, the State Controller's Office will advise the county of this decision by letter. The county must submit a revised (corrected) and acceptable cost plan within 30 days of this notification. When the revised plan is received, it will be reviewed to ensure that it meets the approval requirements.

2. If a county does not respond to the review letter within 30 days of receipt, the State Controller's Office will send the county a "reminder" letter. The county must respond to the State Controller's recommendations within 15 days from the date of this reminder letter.

Should a county continue to fail to respond by the end of the 15-day period, the cost plan review process will be interrupted. If the State Controller's Office deems it necessary, any approval of the cost plan currently in effect may also be rescinded. The State Controller enforces these policies to ensure that the approval process is kept within a 90-day period from the date of the review letter.

1330: Protest Procedures

Protest procedures provide counties with an opportunity to challenge exceptions and recommendations developed by cost plan reviewers. Protests to any findings or recommendations should be included in the county's initial response to the State Controller's Office review letter and/or review report. The protest should, in one of the following formats, specifically address each finding and recommendation to which the county has taken an exception.

1. The exception is substantially correct, but the county proposes to implement a solution that is different than the associated recommendation. The county must include the specific reasons for its proposed solution.
2. The exception is substantially correct, but the county feels that any required revisions will have an immaterial effect on grant programs. Future cost plans will incorporate the recommended procedures.
3. The exception is not correct, and the county protests the exception and the associated recommendation(s).

In the case of situations #2 and #3, the county must provide the State Controller's Office with documents, schedules, and other information that fully support its position and that will permit the State Controller to completely evaluate the validity and adequacy of the response.

1335: The Determination

Upon receipt of the county's response to a review letter and/or report, the State Controller will begin a review and determination process. The response to each finding and recommendation will be evaluated to determine how appropriate it is in light of all cost plan policies and interpretations that were in effect during the fiscal years that the cost plans were in use. All supporting documentation will be reviewed to substantiate or refute any issues of immateriality and/or error raised by the county's response.

One of the following decisions will be made for each item of protest in the county's response.

1. The reviewer's finding and recommendation are sustained. The county must implement the recommendation as it is stated.
2. The reviewer's finding is sustained. However, because any revisions to the cost plan would be immaterial, no adjustments will be required on the part of the county. The county must follow the procedures identified in the recommendation in the preparation of future cost plans.
3. The county's protest is sustained. The finding and associated recommendation are expunged.

The types of decisions cited above are representative of the majority of decisions prepared by the Controller's Office but are not all-inclusive.

If a determination by the State Controller requires adjustments to any cost plan data, the determination will include a statement to the effect that the county must revise the actual costs of the fiscal years included in the review in accordance with the Controller's Office determination. Any corrections resulting from required plan revisions must be identified in the cost summary/exhibit of the next cost plan submitted to the State Controller.

Copies of the Controller's Office determination, including the review, the protest, and details of the determination, will be provided to the county and to DHHS.

1340: Adjustments to Prior-Year Cost Plans

All records that support cost plans are subject to review and audit, and all records that may be reasonably assumed to be relevant to a review or audit must be retained until the audit or review is entirely resolved. The State Controller's right to access any records is not limited to any specific retention period but continues as long as the records are retained (see Section 2180, page 49). The State Controller will not require any adjustments to plans already formally approved, unless:

1. The county provided information that was used as a basis for preparation of all or a part of a formalized cost plan that was subsequently found to be materially incomplete or inaccurate and

resulted in a substantial inequity to either central support or operating departments;

2. Changes are made to the organizational structure or accounting methods of the county that materially affect the amount of reimbursement resulting from the use of amounts approved in the cost plan; or
3. The approved plan was not accurately implemented or a duplication of cost resulted from the use of the plan.

1345: The Appeal Process

Through the appeal process, a county has the opportunity to request reconsideration of any review findings or recommendations upheld by the State Controller. Upon receipt of a determination package, the county should review the State Controller's decisions. If the county disagrees with any part of the determination package, a formal request for review of the item or items in question may be made to DHHS. Counties have 60 days from the date of a determination cover letter to submit a formal appeal to:

Division of Cost Allocation
Department of Health and Human Services
50 United Nations Plaza, Room 347
San Francisco, CA 94102

The State Controller's Office will make every effort to resolve disagreements between counties and the State Controller in a fair and equitable manner. Counties should not overburden the appeal process by sending frivolous protests to DHHS.

1350: Cost Plan Adjustments

After a review has been completed, adjustments may be required to correct cost plan(s) that have been reviewed. The required adjustments must be identified as "prior year adjustments" in the next cost plan submitted to the State Controller for review and approval.

1355: Types of Approvals

The Controller's Office currently issues formal and provisional cost plan approvals. Each type of approval is distributed to all appropriate state and federal grantor agencies as well as to the county.

1360: Formal Approval

A formal approval consists of a formal negotiation agreement signed by the Controller's Office and an authorized representative of the county. The approval signifies that the county has followed all applicable federal and state costing principles in preparing its cost allocation plan. Additionally, the cost summary/exhibit attached to the approval reflects the actual costs allocated to operating departments.

Section II of the negotiation agreement validates the billing mechanisms used by the county in charging its programs for the various support services (see Section 1395). All federal grantor agencies accept and honor this agreement when determining allowable costs for reimbursing the county. State grantor agencies that distribute federal flow-through funds will, in the absence of a specific agreement to the contrary, also accept and honor this agreement when determining allowable costs for reimbursing the county. Both indirect

central support services costs and direct charges associated with grants and contracts will be accepted.

1365: Reliance upon Formal Approval

Formal cost plan approval signifies that both the Controller's Office and the county have accepted the plan costs as final costs for the applicable fiscal year. Both parties are equally bound by the negotiation agreement and are entitled to rely on the agreement, subject to its terms and conditions, including any limitations recorded in the plan or the plan's negotiation agreement. The plan's approved actual costs are considered to be closed and not subject to adjustment, either retroactively or by carry-forward to a future year, unless they violate a condition stated in Section 1340, page 18, of this handbook.

1370: Changes to Formally Approved Cost Plans

Changes to the costs presented in formally approved cost plans will be allowed only when a subsequent examination or audit reveals inequities or factual errors and the State Controller determines the amounts involved to be material.

Approved costs are considered to be closed. No changes will be allowed unless a compelling reason exists either in law, statute, or regulation that requires the reopening of negotiations.

1375: Provisional Approvals

Only the State Controller's representative signs a provisional agreement. It is subject to later revision pending a subsequent review.

A provisional approval is identical in all other respects to a formal approval. It is distributed to, and must be used by, all federal and state grantor agencies in reimbursing the county for the indirect costs associated with its federally funded grants and contracts.

1380: Approval Methodology

All proposed countywide cost allocation plans will be reviewed, negotiated, and approved by the State Controller's Office on a timely basis. Plans will be reviewed within six months of receipt. The State Controller's Office will notify the county of any required additional information and/or documentation, or if changes are required in the county's prepared plan. After an agreement with the county has been reached, the agreement will be accepted and used by all county agencies unless prohibited or limited by statute. If a federal funding agency believes that special operating factors affecting its awards necessitate special consideration, the funding agency must, prior to the time the plans are negotiated, notify the State Controller.

1385: Fixed (Estimated) with Carry-Forward

Allocated central service costs are usually negotiated and approved for the following fiscal year on a "fixed (estimated) with carry-forward" basis. Under this procedure, the fixed (estimated) amounts for the future year covered by the agreement are not subject to adjustment for that year. However, when the actual costs of the year involved become known, the differences between the fixed (estimated) amounts previously approved and the actual costs will be carried forward and used as an adjustment to the fixed (estimated) amounts established for a later year. This "carry-forward" procedure applies to all central support services whose costs were fixed (estimated) in the approved plan. A carry-forward adjustment is not

permitted for a central support or an operating activity that was not included in the approved plan or for unallowable costs. When unallowable costs have been claimed and reimbursed, they will be refunded to the program that reimbursed the unallowable cost using one of the following methods:

1. A cash refund;
2. An offset to a subsequent claim; or
3. Credits to the amounts charged to individual awards.

1390: Indirect Cost Claiming: Amounts vs. Rates

The cost summaries/exhibits attached to formal and provisional negotiation agreements contain only the unbilled amount of services and overhead pertaining to the operating departments, carry-forward, and other required adjustments. The total amounts identified to each department are not converted to departmental “indirect cost rates,” and the State Controller’s Office will not approve any cost summary/exhibit containing such rates. If the county wishes to utilize such rates in its claiming process, it must prepare departmental indirect cost rate proposals using the amounts identified on the cost summary/exhibit and submit its proposals to the appropriate grantor agencies. Major grant programs in California have established their indirect cost claiming formats to recognize a dollar amount of indirect cost as identified on the cost summary, as opposed to recognizing a rate that is applied to some appropriate base.

1395: Examples of Approvals

Examples of formal and provisional negotiation agreements can be found in Exhibit 1301, pages 23-25, and Exhibit 1302, pages 26-28. These agreements share the following common elements.

Introductory Paragraphs

The general heading identifies the type of approval, the date of issue by the State Controller’s Office, and the county to which it is issued. A formal negotiation agreement may be distinguished from a provisional agreement by its heading and by the inclusion of a signature block signed by both a county and a State Controller representative.

The paragraph immediately following the heading identifies the fiscal years covered by the agreement, and includes a statement to the effect that the State Controller’s Office either formally or provisionally approves, pursuant to OMB A-87, a countywide cost allocation plan for use as an actual plan for a given fiscal year. A provisional negotiation agreement will state that there is a possibility of a future field review before the associated plan can be granted formal approval.

The third paragraph contains a statement concerning data processing system costs. General data processing system costs that have a countywide application are considered allowable for grant reimbursement purposes. However, those costs that are applicable specifically to a grantee department may require the prior approval of the grantor agency before being considered eligible for reimbursement.

Section I - Costs Distributed Through Countywide Cost Allocations

Section I of both a formal and a provisional approval pertains to the cost summary/exhibit. The cost summary/exhibit is attached to, and distributed with, the approval to all concerned state and federal agencies. The cost summary/exhibit is a compilation of all unbilled central support and indirect overhead costs allocated to the operating departments listed in the cost summary/exhibit. These costs are approved as actual costs of a given fiscal year and are normally used as the estimated costs for the fiscal year indicated. The amounts identified on the cost summary/exhibit are to be included, along with the other costs of a department, for further allocation to the grants and contracts being performed by that department on a reimbursable basis.

Any differences between the amount cited on the cost summary/exhibit and the actual costs of the fiscal year for which the summary serves as an estimate will be considered in a subsequent negotiation agreement.

Section II - Costs Distributed Through Billing or Transfer Mechanisms

Section II of either a formal or a provisional negotiation agreement pertains to central support or indirect overhead costs that are distributed through billing mechanisms. The cost centers identified in this section have been approved to charge for their services during the fiscal year. Billing mechanisms and adjustment procedures have been approved in accordance with the proper costing principles.

Any variances resulting from differences between billed costs and the actual experience of a particular accounting period will be considered in a subsequent approval.

Section III – Conditions

Section III of either a formal or a provisional negotiation agreement identifies the limitations and conditions under which the approval is accepted for use for grant reimbursement purposes. Each item identified in this section is self-explanatory. Any conditions included under *Section III. F*, Special Remarks, are mandatory and must be implemented in the specified plan(s) by all agencies to which they apply.

Section IV – Acceptance

Section IV of the formal approval constitutes the acceptance of the approval by the county and by the State Controller, acting as the responsible negotiation agency. The chief accounting officer of the county should sign it. The agreement will be considered formalized when an official designated by the State Controller also signs it. Provisional negotiation agreements are signed only by an official designated by the State Controller.

This section also identifies the Controller's Office cost plan analyst who negotiated the negotiation agreement with the county.

Exhibit 1301



STEVE WESTLY

Controller of the State of California

**NEGOTIATION AGREEMENT
COUNTYWIDE COST ALLOCATION PLAN**

County of _____, California
_____, CA

Date: _____
Filing Ref: _____

Pursuant to OMB A-87, the State Controller's Office formally approves the Countywide Cost Allocation Plan as described in Section I for use in the _____ fiscal year. This approval is subject to the conditions contained in Section III.

Departmental indirect cost proposals should clearly identify those costs that have been distributed through Sections I and II of this agreement in accordance with the guidelines of the responsible grantor agency for that department. Further, data processing systems may be subject to grantor agency approval prior to the reimbursement of certain costs allocated, billed, or cost applied from the Data Processing Department.

SECTION I: COSTS DISTRIBUTED THROUGH COUNTYWIDE COST ALLOCATIONS

The indirect overhead and support service costs listed in _____ are formally approved as actual costs for the _____ fiscal year and as estimated costs for the _____ fiscal year on a "fixed with carry-forward" basis. These costs may be included as part of the costs of the county departments indicated effective **July 1, _____**, for further allocation to federal grants and contracts performed by the respective county departments.

-2-

County of _____

SECTION II: COSTS DISTRIBUTED THROUGH BILLING OR COST-TRANSFER MECHANISMS

- | | |
|-----------------------------|-----|
| 1. Employee Fringe Benefits | 11. |
| 2. | 12. |
| 3. | 13. |
| 4. | 14. |
| 5. | 15. |
| 6. | 16. |
| 7. | 17. |
| 8. | 18. |
| 9. | 19. |
| 10. | 20. |

In addition to Section I, which provides for services furnished but not billed, the services listed above are furnished and billed to state/local departments and agencies.

Direct charges from the above centers should be billed or cost applied in accordance with the procedures established by the county as described in its Countywide Cost Allocation Plan and may be included as part of the costs of the county departments indicated in Section I.

SECTION III: CONDITIONS

A. LIMITATIONS: Use of the amounts contained in this Negotiation Agreement are subject to any statutory or administrative limitations and, when ultimately allocated to individual grants or contracts through the indirect cost proposals of each county department, are applicable only to the extent that funds are available. Acceptance of the amounts agreed to herein is predicated on the conditions: (1) that no costs other than those incurred by the county were included for distribution in its Countywide Cost Allocation Plan as finally accepted, and that such costs are legal obligations of the county and allowable under the governing cost principles; (2) that similar types of costs have been accorded consistent accounting treatment; and (3) that the information provided by the county that was used as the basis for acceptance of the amounts agreed to herein is not subsequently found to be materially incomplete or inaccurate.

B. CHANGES: Fixed amounts contained in this Negotiation Agreement are based on the organizational structure and the accounting system in effect at the time the proposal was submitted. Significant changes in the organizational structure or changes in the method of accounting for costs that materially affect the amount of reimbursement resulting from use of the amounts in this Negotiation Agreement will require prior approval of the authorized representative of the responsible negotiation agency. Failure to obtain such approval may result in subsequent audit disallowances.

C. FIXED AMOUNTS: The fixed amounts contained in Section I of this agreement are based on an estimate of the costs that will be incurred during the period to which the amounts apply. When the actual costs for this period are determined, any differences between the fixed costs used as an estimate and the actual costs will be considered in a subsequent agreement.

D. BILLED COSTS: Charges for the services cited in Section II will be billed or cost applied in accordance with the procedures established by the county and recorded on the books of the cost center providing the service. Such charges will be based on the actual allowable costs, as defined by OMB A-87, incurred by the cost center responsible for providing the service. Any differences between the billed allowable costs and the actual allowable costs for a particular accounting period will be considered in a subsequent agreement.

E. NOTIFICATION TO STATE AND FEDERAL AGENCIES: Copies of this document will be provided to other state and federal agencies as a means of notifying them of this approval.

F. SPECIAL REMARKS:

SECTION IV: ACCEPTANCE

COUNTY OF _____

BY _____

Name

Title

Date

**STEVE WESTLY
STATE CONTROLLER**

BY _____

Chief Deputy State Controller, Finance

Date

Negotiated by _____

Telephone (916) _____

cc: State and Federal Agencies

Attachment

Exhibit 1302



STEVE WESTLY

Controller of the State of California

PROVISIONAL APPROVAL COUNTYWIDE COST ALLOCATION PLAN

County of _____, California
_____, CA

Date: _____
Filing Reference: _____

Pursuant to federal Office of Management and Budget (OMB) Circular A-87, the State Controller's Office provisionally approves the Countywide Cost Allocation Plan as described in Section I for use in the _____ fiscal year. This approval is subject to the conditions contained in Section III. A field examination may be necessary for the plan to be granted formal approval.

Departmental indirect cost proposals should clearly identify those costs that have been distributed through Sections I and II of this agreement in accordance with the guidelines of the responsible grantor agency for that department. Further, data processing systems may be subject to grantor agency approval prior to the reimbursement of certain costs allocated, billed, or cost applied from the Data Processing Department.

SECTION I: COSTS DISTRIBUTED THROUGH COUNTYWIDE COST ALLOCATIONS

The indirect overhead and support service costs listed in the _____ are provisionally approved as actual costs for the _____ fiscal year and as estimated costs for the _____ fiscal year on a "fixed with carry-forward" basis. These costs may be included as part of the costs of the county departments indicated effective **January 1, _____**, for further allocation to federal grants and contracts performed by the respective county departments.

-2-

County of _____

SECTION II: COSTS DISTRIBUTED THROUGH BILLING OR COST-TRANSFER MECHANISMS

- | | |
|-----------------------------|-----|
| 1. Employee Fringe Benefits | 6. |
| 2. | 7. |
| 3. | 8. |
| 4. | 9. |
| 5. | 10. |

In addition to Section I, the services listed above are furnished and billed to state/local departments and agencies.

Direct charges from the above centers should be billed or cost applied in accordance with the procedures established by the county as described in its Countywide Cost Allocation Plan and may be included as part of the costs of the county departments indicated in Section I.

SECTION III: CONDITIONS

A. LIMITATIONS: Use of the amounts contained in this Provisional Approval are subject to any statutory or administrative limitations and, when ultimately allocated to individual grants or contracts through the indirect cost proposals of each county department, are applicable only to the extent that funds are available. Acceptance of the amounts agreed to herein is predicated on the conditions: (1) that no costs other than those incurred by the county were included for distribution in its Countywide Cost Allocation Plan as finally accepted, and that such costs are legal obligations of the county and allowable under the governing cost principles; (2) that similar types of costs have been accorded consistent accounting treatment; and (3) that the information provided by the county that was used as the basis for acceptance of the amounts agreed to herein is not subsequently found to be materially incomplete or inaccurate.

B. CHANGES: Fixed amounts contained in this Provisional Approval are based on the organizational structure and the accounting system in effect at the time the proposal was submitted. Significant changes in the organizational structure or changes in the method of accounting for costs that materially affect the amount of reimbursement resulting from use of the amounts in this Provisional Approval will require prior approval of the authorized representative of the responsible negotiation agency. Failure to obtain such approval may result in subsequent audit disallowances.

C. FIXED AMOUNTS: The fixed amounts contained in Section I of this Provisional Approval are based on an estimate of the costs that will be incurred during the period to which the amounts apply. When the actual costs for this period are determined, any differences between the fixed costs used as an estimate and the actual costs will be considered in a subsequent agreement.

D. BILLED COSTS: Charges for the services cited in Section II will be billed or cost applied in accordance with the procedures established by the county and recorded on the books of the cost center providing the service. Such charges will be based on the actual allowable costs, as defined by OMB Circular A-87, incurred by the cost center responsible for providing the service. Any differences between the billed allowable costs and the actual allowable costs for a particular accounting period will be considered in a subsequent agreement.

E. NOTIFICATION TO STATE AND FEDERAL AGENCIES: Copies of this document will be provided to other state and federal agencies as a means of notifying them of this approval.

F. SPECIAL REMARKS:

**STEVE WESTLY
STATE CONTROLLER**

BY _____
Chief Deputy State Controller, Finance

Date

Exhibit 1303**SUPPLEMENTAL INFORMATION CHECKLIST****COUNTY OF _____****FY ____ / ____ COUNTYWIDE COST PLAN**

Completed by _____

Date Completed _____

A complete checklist must accompany each cost plan submitted to the State Controller's Office.

*All "No" answers must be fully explained in the comments at the end of this checklist or in a separate document attached to the checklist.

- | | YES | NO * |
|---|------------|-------------|
| 1) Does the cost plan contain a certification, dated and signed by the county's chief accounting officer? (A cost plan submitted without a signed and dated certification is not acceptable.) | _____ | _____ |
| 2) Does the submitted package contain a separate 8 1/2" x 11" typed or printed consolidated schedule of allocated costs by department? | _____ | _____ |
| 3) Has a copy of the county's budget and central support expenditures and revenue ledgers been included? | _____ | _____ |
| 4) Do all costs, expenditure transfers (inter/intrafund), and revenues shown in the cost plan reconcile to the budget or financial statement? (If not, a reconciliation schedule must be provided.) | _____ | _____ |
| 5) Does the cost plan contain narratives describing each external overhead support service, internal service fund, and self-insurance trust fund? (Narratives should be updated each year to reflect changes from prior years.) | _____ | _____ |
| 6) Does the cost plan contain the most recent financial statements/comprehensive annual financial report (CAFR), and descriptions for each central support internal service fund and each self-insurance trust fund? If financial notes are not included in the CAFR, they must be provided describing the county's risk management program, pension program, and any pension obligation bonds. | _____ | _____ |
| 7) Are the net assets for each central support internal service fund appropriately reported? The net assets and the components of the billing rate(s) for each central support internal service fund must be provided in sufficient detail so that the State Controller may analyze the adequacy of the working capital available to each fund and the reasonableness of its billing rates. | _____ | _____ |

Net Assets Detail

Net assets invested in capital assets (net depreciation and related debt)	XXX
Net assets restricted (imposed externally or by law)	XXX
Net assets – unrestricted	
Accumulated through replacement charges – Estimated price increase charges	XXX
Accumulated through depreciation charges	XXX
Unrestricted net assets available for current expenses - Working capital	<u>XXX</u>
Total unrestricted net assets	<u>XXX</u>
Total net assets	<u>XXX</u>

	YES	NO*
8) Is an explanation provided for each transfer from internal service funds and self-insurance funds?	_____	_____
9) Does the plan include a complete Exhibit 4401 for each county insurance plan? Each Exhibit 4401 must include a thorough explanation of how insurance costs are distributed to all of the departments and funds that participate in the shared risk. Each explanation must include the percentage weights assigned to experience and exposure. The discussion of loss history must report: the number of years and the specific/relative years used to determine loss history; the types of losses included in the loss history – actual losses, losses incurred but not reported, estimated losses, etc.; and whether individual losses are capped at some specific amount. The discussion of loss exposure must report the type of data used to assign loss exposure (risk) by department. The date of the most recent actuarial study must be disclosed for each Exhibit 4401.	_____	_____
If an actuarial summary report was performed for any county self-insurance program, is it enclosed? (Actuarial summary reports must be prepared no less frequently than biennially.)	_____	_____
10) Does the cost plan contain a detailed listing and acquisition/rental cost of space acquired, leased, or rented?	_____	_____
11) Does the cost plan contain an explanation of significant changes from procedures as reported in the previous cost plan?	_____	_____

- 12) List and indicate the status of any central support service department that will change from allocating costs to billing costs or vice versa.

- 13) List all central support service departments, including proprietary funds, that directly bill county department(s).

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<hr/>	<hr/>	<hr/>

Items 14 and 15 are to be completed by the individual responsible for preparing the county's administrative expense claim, which is submitted to the State Department of Social Services.

- 14) List the social services/human services budget unit(s) claimed on the administrative expense claim.

- 15) Are controls in place to ensure that cost plan charges that were actually billed during the year are either applied to reduce allocated cost plan expenditures or are not claimed as direct expenditures? **YES** **NO***

Items 14 and 15 certified by:

(Required Signature)

(Title)

- 16) If the county has issued pension obligation bonds, please answer the following questions and submit any amplifying information.

- a. Were all proceeds deposited with the county retirement system and applied to the system's unfunded actuarial accrued liability (UAL)? _____
- b. Are the interest rates on the bonds issued lower than the UAL's actuarially assumed interest rate? _____
- c. Are pension costs, including the debt financing of the UAL, less costly than the cost of regular pension financing over the remaining unamortized life of the UAL? _____

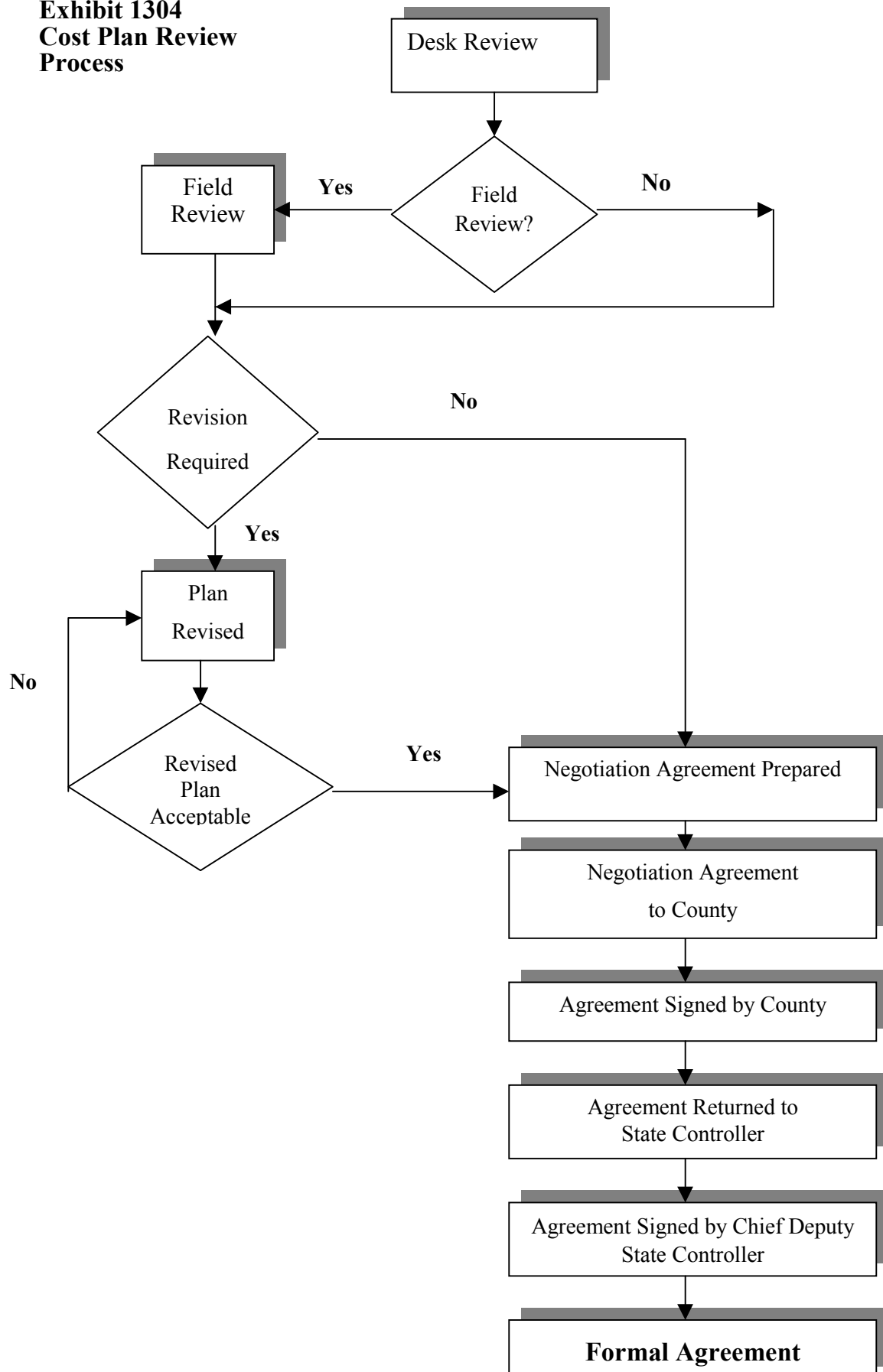
Items 17 and 18 are applicable only to the 22 counties that elected to establish either an independent retirement system or a system under the County Employee Retirement Law of 1937.

- | | YES | NO* | N/A |
|---|-------|-------|-------|
| 17) Does the cost plan contain a Certificate of Actuarial Assumption, dated and signed by a responsible official, on excess reserves of the pension trust funds? | _____ | _____ | _____ |
| 18) Does the cost plan contain a narrative providing information on the pension contribution rates and describing how the administrative costs of the retirement systems are charged to the departments administering federal programs? | _____ | _____ | _____ |

Under the 1937 Act, the Retirement Board may elect to pay for administrative costs from the earnings of the pension trust fund. If these costs are paid by the retirement fund, they are included in the rates that are billed directly to the departments. If the board does not elect this option, these costs are charged against the county general fund and treated as an indirect cost in the cost allocation plan.

This image shows a single sheet of white paper with horizontal blue ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

**Exhibit 1304
Cost Plan Review
Process**



Section 1400: County Cost Plan Preparation

Two major factors should be considered when preparing a cost plan. First, because the accuracy and completeness of the cost allocations must be maximized, the individual who is responsible for preparing the cost plan should be familiar with the overall operations of the county and with how the county's financial data is recorded. Second, the county's cost plan coordinator should be an individual familiar with all grant programs in order for the county to maximize reimbursements for indirect costs.

1410: Cost Plan Coordinator

The cost plan coordinator should be an individual who is familiar with the organizational structure and fiscal operations of all county departments. The total value of indirect services received by county operating departments from central support departments is identified through the cost plan. These values must be offset by any direct charges imposed during the year. The completeness and accuracy of the plan is essential so that the costs of central support services may be properly determined. A complete and accurate cost plan is also essential to budget preparation, and it ensures that the maximum valid reimbursable indirect costs are claimed from the agencies that administer the county's grant programs. Experience has shown that the best person to coordinate the recovery of indirect costs is usually a member of the county's accounting department or an employee of a department that deals with the overall fiscal operations of the county.

1420: Cost Plan Certification

A cost plan submitted to the State Controller must be accompanied by a certification that provides the information specified in OMB A-87, Attachment C, Section E.4. The official responsible for the county's overall fiscal operations must sign this certification. In California, this individual is the chief accounting officer for the county, normally the county auditor (or auditor-controller), or an authorized deputy. The cost plan cannot be certified by the cost plan coordinator unless that individual is also the county chief accounting officer or that officer's authorized deputy.

1430: Grants Management Coordinator

After the State Controller has approved a county's cost plan, copies of the approval and the attached cost exhibit/cost summary are mailed to the county and to a number of state and federal agencies. The county's grants management coordinator is responsible for instructing these agencies on the significance and proper use of the cost plan. In many cases the county's grants management coordinator also serves as the cost plan coordinator.

County departments that receive reimbursements for their programs, as well as any departments that charge non-county agencies for their services, will find cost plan allocations to be especially useful. Cost plans allow a county to maximize the recovery of indirect costs recorded in its cost plan's summary schedules/exhibits. Since there is no one complete

listing of all state and federal grant programs that reimburse indirect costs, full recovery of indirect costs is not a simple task.

The grants management coordinator should interview all county department heads to determine if any of their programs are eligible for reimbursement. After these programs have been identified, each individual grant or contract should be analyzed to determine to what extent indirect costs are reimbursable. To aid the grants management coordinator in this task, the Grants Management Advisory Service in Washington, DC, publishes the Federal Grants Management Handbook (<http://www.thompson.com>). This publication outlines the entire grant management and accounting process, identifies those federal departments having grant programs, and provides a monthly summary of the latest current developments affecting federal grants.

Once reimbursable programs are identified, the grants management coordinator should monitor the reimbursement process to ensure that maximum reimbursements have been received by the county for all program costs, including indirect overhead. Additionally, any departments that charge outside agencies for their services should be monitored to ensure that the billing structures used recover all applicable costs, including indirect overhead.

**1440: Grantee
Departments' Use
of Cost Plan**

County departments receiving reimbursement for costs through federal and state grants should use the county's approved cost plan in the grant claiming process. Grant claims should be prepared and submitted in accordance with the applicable regulations and procedures established by the appropriate grantor agency, and they should recognize and include the amounts identified to the respective departments on the approved cost summary/exhibit.

Unless there is a specific agreement to the contrary, all federal grantor agencies and state agencies with federal flow-through funds must accept the countywide cost allocation plan as approved by the State Controller's Office and must reimburse indirect costs incurred by county grantee departments in accordance with the approved cost summary/exhibit. Some grant programs funded solely by the State of California do not entirely recognize the amounts approved on the cost summary/exhibit. Some state departments have taken exception to the "fixed with carry-forward" concept of adjusting estimated costs to actual costs, contending that this constitutes payment of prior-year costs from current-year appropriations.

**1450: Indirect Costs
Used as Matching
Share**

Some federal grants do not provide funds for the reimbursement of indirect costs. However, if these same grants require the county to "match" a specified portion of the overall costs of the grant program, the indirect overhead costs identified in the cost plan can be included in the county's matching share.

**1460: Non-Grantee
Departments' Use of
Cost Plan**

Non-grantee departments charging for their services can utilize the cost plan in determining their billing rate structures. If a department charges the public a fee for a service it provides, the board of supervisors should be aware of the total cost of providing that service, including all applicable indirect costs. This will allow the supervisors to establish fees at the appropriate level to recover the true costs associated with the services provided. Even if the department is not charging a fee for the service, this concept can be employed as a management tool in identifying countywide overhead costs to all applicable departments. Non-grantee departments should note the cost recovery limits set by OMB A-87 and, if necessary, adjust their costs to recover as nearly as possible the total costs of doing business.

**1470: Full
Costing Plan**

Although the cost plan as approved by the State Controller's Office includes only those costs considered reimbursable for federal and state purposes under the current cost principles, it is the best tool available to accomplish the task described above. A county could prepare a "full costing plan" to identify all county overhead costs to the appropriate departments, including those costs that are currently considered unallowable (e.g., general government costs). If a method can be devised in which the "cost reimbursement plan" and the "full costing plan" can be prepared simultaneously, while still allowing the identification and approval of only the portion pertaining to grant reimbursements, then the entire package could be submitted to the State Controller's Office for approval. Otherwise, the "full costing plan" should be prepared separately and retained by the county for management purposes.

Exhibit 1401

CERTIFICATION OF COST ALLOCATION PLAN

This is to certify that I have reviewed the cost allocation plan submitted herewith and to the best of my knowledge and belief:

- (1) All costs included in this proposal (identify date) to establish cost allocations or billings for (identify period covered by the plan) are allowable in accordance with the requirements of OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, and the federal award(s) to which they apply. Unallowable costs have been adjusted for in allocating costs as indicated in the cost allocation plan.
- (2) All costs included in this proposal are properly allocable to federal awards on the basis of a beneficial or causal relationship between the expenses incurred and the awards to which they are allocated, in accordance with applicable requirements. Further, the same costs that have been treated as indirect costs have not been claimed as direct costs. Similar types of costs have been accounted for consistently.

I declare that the foregoing is true and correct.

Government Unit: _____

Signature: _____

Name of Official: _____

Title: _____

Date of Execution: _____

Section 1500: Audits

Authority to audit county cost plans usually lies with the federal agency having cognizance for the approval of these plans. In California, DHHS' designee, the State Controller's Office, is responsible for the audit and approval of all 58 countywide cost allocation plans. The audits of cost plans will be performed under the policies and procedures set forth in OMB A-87, ASMB C-10, this handbook, and any other guidance issued by DHHS and the State Controller's Office in effect during the years the cost plans under audit were in use.

If any county audit includes findings or recommendations that address or apply to the county's cost plan, a copy of the audit report and the county's reply to the report must be provided to the State Controller's Office for review and comment. The State Controller's Office must also be advised if any prior-year cost plans considered to be outside of the retention period policy will require adjustments.

1510: Audit of Formally Approved Plans

The benefits of an audit are maximized if the audit recommendations are available before a cost plan is granted formal approval. However, situations may be encountered where audits are performed on a "post-audit" (audit of an approved plan) basis. If a cost plan that has already been granted a formal approval is audited, no adjustments will be made to the plan except in the unusual circumstances outlined in Section 1370, page 20, of this handbook, or when both parties agree to reopen negotiations. Post-audits of formally approved plans are generally useful only to the extent that they result in the implementation of improved methodology for future plans.

1520: The Protest

The protest constitutes the county's first opportunity to refute the exceptions taken by cost plan auditors. Counties must respond, in the format prescribed by the agency that conducted the audit, to all audit findings for all fiscal years covered within the scope of the audit. It is the responsibility of the county that has been audited to provide the State Controller with all audit information, including audit protests, that pertains to its cost plans or to its cost plan procedures.

1530: The Determination

When a county's protest is received, the State Controller begins a determination process. Each cost plan finding and/or exception is studied to determine how appropriate the corresponding recommendation is in light of the policies and interpretations of OMB A-87, ASMB C-10, and this handbook that were in effect during the fiscal years the plans under audit were in use. The county's response and any supporting documentation are reviewed to substantiate issues of immateriality or incorrectness. A determination is then developed for each item in the format specified in Section 1325, page 17, of this handbook. Counties may appeal any review findings or recommendations upheld by the State Controller, in accordance with Section 1345, page 19, of this handbook.

Should the determination by the State Controller involve adjustments to cost plan data, the determination will contain a concluding statement to the effect that the county must revise the actual costs of the fiscal years under audit in accordance with the previously discussed determinations. Any corrections resulting from required plan revisions should be identified on the cost summary/exhibit of the next cost plan submitted to the State Controller's Office.

Copies of the determination packet, containing a copy of the audit, the protest, and the determination, will be distributed to the county, the audit agency, and DHHS.

1540: Program Audits

In the course of their audits, program auditors may examine the charges to federal and state programs from the cost plan. The extent of their authority in reviewing these charges is limited to determining whether or not these indirect costs approved for use by the State Controller were claimed properly by the grantee department. Inherent in this examination is the necessity for the program auditors to determine if any costs claimed directly by the grantee were also claimed as an indirect cost via the cost plan.

If a county receives a program audit report containing an exception that pertains to a claiming error, in most cases the cost plan will remain intact as approved. Any required adjustments will be made on the claims submitted to the grantor agency. If the same report contains an exception that pertains to the preparation of the cost plan, the State Controller's Office should be notified and will resolve the issue. Since more than one department or fiscal year may be affected, at no time should the county and the grantor agency or its auditors attempt to adjust any costs identified in the cost plan without first notifying the State Controller's Office and receiving its concurrence.

1550: The Single Audit Act

The Single Audit Act is intended to establish uniform requirements for audits of federal awards administered by non-federal entities. It is designed to promote the efficient and effective use of audit resources and to reduce the burdens on state and local governments, Indian tribes, and nonprofit organizations. It ensures that federal departments and agencies, to the maximum extent practicable, rely upon and use audit work done pursuant to Chapter 75 of Title 31, United States Code, as amended. The Single Audit Act makes audit requirements uniform for all types of grantees and stipulates that government auditing standards are to be followed in all audits of state and local governments conducted in accordance with the Act. The cognizant agency for each audit is the federal agency designated to carry out single audit responsibilities. The oversight agency for each audit is the federal agency that provides the predominate amount of direct funding to a recipient not assigned a cognizant agency for audit purposes. When there is no direct funding, the federal agency providing the greatest amount of indirect funding is assigned oversight responsibilities.

Under the provisions of the Single Audit Act, all federal agencies may use the results of single audits as a base from which to perform grant- and program-specific audit requirements.

Part II: Preparation Requirements for Cost Plans

Section

2100:	Acceptable Cost Allocation Plans	45
2110:	Claiming Reimbursement	45
2120:	Acceptable Costs	45
2130:	Required Supporting Documentation	46
2140:	Cost Plan Development	46
2150:	Identifying Costs	47
2160:	Narratives	48
2170:	Documentation for Reviews and/or Audits	49
2180:	Record Retention Requirements	49
2190:	Access Rights	50
2195:	Summary	50
2200:	Costs, Revenues, Reimbursements, and Other Credits	51
2210:	Allowable Income (Revenue)	51
2215:	Applicable Credits	51
2220:	Examples of Applicable Credits	51
2230:	General Billing Requirements	52
2235:	Internal Service Funds (ISFs)	53
2240:	Adjusting ISF Billing Rates	53
2245:	ISF Net Assets	54
2250:	ISF Loans	55
2255:	Self-Insurance Funds	55
2260:	Distribution Formula	56
2265:	Probable Incurred Liability	56
2270:	Central Support Budget Units	56
2275:	Partial Direct Billing	56
2280:	Memo Billing	57
2290:	Allowable Necessary Costs	57
Exhibit 2201:	Cost Plan Terminology	59
2300:	Allowable Compensation for Personnel Services	63
2310:	Required Supporting Documentation	63
2320:	Personnel Activity Reports	63
2330:	Acceptable Substitute Systems	64
2340:	Purpose of Documentation	64

2350:	Summary	65
	Exhibit 2301: Examples of Time-Reporting Requirements	66
	Exhibit 2302: Sample Personnel Activity Report.....	67
2400:	Allowable and Allocable Support Service and External Overhead Costs	68
2410:	Classifying Costs	68
2420:	Allowable Activities	68
2430:	Interpreting Allowable Costs and Activities	69
2440:	Unallowable Costs and Activities	70
2450:	Factors Affecting the Allowability of Costs	70
2460:	Allocable Costs	71
2470:	Choosing an Allocation Base	71
2480:	Summary	72
2500:	Depreciation and Use Allowances.....	73
2510:	Depreciation Defined	73
2520:	Use Allowance Defined	73
2530:	Depreciation and Use Allowance Conditions	73
2540:	Allowable Financing Costs	73
2600:	Electronic Data Processing – Grant Agency Approval	75

Section 2100: Acceptable Cost Allocation Plans

California recognizes and accepts two types of cost allocation plans. The first, the type of cost plan over which the State Controller's Office has cognizance, identifies and distributes overhead and central support service costs that have been incurred to provide services or benefits to all county departments. These identified costs are assigned to all county departments, whether or not they receive grants or perform contracts for the federal government or the State of California. This type of plan is commonly referred to as a "countywide cost allocation plan."

The second type of plan, a "departmental indirect cost rate proposal," has a narrower focus than the countywide plan. Plans of this type are discussed in OMB A-87, Attachment E. These plans identify and distribute the overhead and administrative costs of an operating department, including costs assigned to the department under the countywide plan, to programs administered by the department. This type of plan is not included as part of the countywide cost allocation plan. OMB A-87, Attachment E, Section D, requires government units that have developed indirect cost rate proposals to maintain these proposals and supporting documentation for audit. They are not required to submit their proposals unless they are specifically requested to do so by their cognizant agency.

The State Controller's Office approves countywide cost allocation plans only as a method of assigning indirect costs for grant reimbursement purposes; it has no cognizance over "departmental indirect cost proposals."

2110: Claiming Reimbursement

Unless there is a specific formal agreement between a county unit and a grant agency, the only method by which California counties may claim reimbursement for indirect and central support service costs from grantor agencies is through a countywide cost allocation plan that has been approved by the State Controller's Office. Consequently, it is important that counties comply with the cost principles in OMB A-87, ASMB C-10, and this handbook. Failure to comply with these principles will, absent a specific agreement with a particular grantor agency, preclude a county from recovering costs that are legitimate charges to federal and state grants and contracts.

2120: Acceptable Costs

In order to be acceptable for reimbursement, costs presented in the countywide cost allocation plan must:

1. Reflect the standards and policies contained in OMB A-87, ASMB C-10, and this handbook;
2. Be necessary and reasonable for proper and efficient performance and administration of federal awards;
3. Be allocable to federal awards under the provisions of OMB A-87;
4. Be authorized or not prohibited under state or local laws or regulations;
5. Conform to any limitations or exclusions set forth in OMB A-87, federal laws, terms and conditions of the federal award, or other governing regulations as to types or amounts of cost items;

6. Be consistent with policies, regulations, and procedures that apply uniformly to both federal awards and other activities of the governmental unit;
7. Be accorded consistent treatment, i.e., a cost may not be assigned to a federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the federal award as an indirect cost;
8. Except as otherwise provided for in OMB A-87, ASMB C-10, or this handbook, be determined in accordance with generally accepted accounting principles and/or governmental generally accepted accounting principles;
9. Not be included as a cost or used to meet cost-sharing or matching requirements of any other federal award in either the current or a prior period, except as specifically provided for by federal law or regulation;
10. Be an amount net of all applicable credits and direct charges for services provided; and
11. Be adequately documented.

2130: Required Supporting Documentation

All countywide cost allocation plans must include the certification referred to in Section 1420, page 35, of this handbook. An example of the required certification is provided in Exhibit 1401, page 38.

The audited official financial records of the county must support all cost plans. For California counties, the absolute minimum required documentation consists of a budget that contains the final revenue and expenditure amounts upon which the plan is based, plus the other documents required by the annual Supplemental Information Checklist (Exhibit 1303, pages 29-33). If this budget is not already on file with the State Controller when the cost plan is submitted, a copy must be included with the plan. Any differences between cost plan line items and corresponding line items recorded in the budget must be fully reconciled in supporting documentation that accompanies the cost plan.

Each cost plan must be accompanied by a schedule of financing sources fully describing and reporting the source of all revenues and interfund and intrafund transfers received by each central support department.

2140: Cost Plan Development

By using the following steps, counties can ensure complete documentation and proper organization in the development of their countywide cost allocation plan.

1. Prepare a county organization chart that clearly shows county operations, including central support service activities. This chart must include county central support service units and county operating units and depict their interrelationships. A copy of this chart must be initially provided to the State Controller's Office and an updated version forwarded when any significant organizational changes occur.
2. Interview department managers to determine those departments that provide services to other county departments or units. Any external

overhead that is applicable to all departments should also be identified at this time.

3. Prepare narratives presenting the information described in Section 2160 for each external overhead or support service item. These narratives must be reviewed annually and revised as necessary to ensure that each cost plan includes all county organizational and procedural changes that may have occurred since the last cost plan filed with the State Controller's Office.
4. Distribute each central support service department's expenditures to the department's cost pools, using percentages of effort applied or some other rational basis. Any revenues and transfers in that cannot be readily attributed to a specific department or agency must reduce cost pool expenditures.
5. Prepare detailed schedules for each cost pool, allocating the pooled expenditures to all benefiting departments and employing a rational allocation basis. Any amounts billed or intrafund transferred to the user departments must be deducted from the expenditures allocated to these departments.
6. Transfer the net allocations for each central support department's cost pools to a departmental summary cost schedule. This exhibit consolidates the department's net external overhead and support service costs allocated.
7. Carry forward the summary cost schedule information to the consolidated cost schedules. Use one schedule to compare the total of all costs allocated to each operating department with the corresponding costs used in the cost plan two years previously. Determine the plan carry-forward adjustments from these comparisons. Apply this carry-forward amount, and any other necessary adjustments, to the cost summaries allocated to each operating department to arrive at total allocated cost amounts.
8. On a second schedule, the cost summary/exhibit, report and total the net amounts allotted to each operating department from each central support department's cost allocation summary. Add the computed carry-forward adjustments and any additional required adjustments to this total to arrive at the total adjusted indirect costs that may be claimed by each operating department. These cost summary/exhibit totals are the amounts that may be claimed from federal and state grant programs as reimbursement of indirect costs for each central support department.

2150: Identifying Costs

The best method available for identifying costs to the beneficiaries of the costs incurred is through a formal cost accounting system. If such a system does not exist, the only acceptable alternative is a cost allocation plan. When a cost allocation plan is employed to apportion indirect costs, it is still important for the county to track the actual costs incurred during each fiscal year. This is necessary in order for all estimated indirect costs claimed by grant programs through the cost plan to be adjusted to actual costs by carry-forward adjustments in future accounting periods (see Section 2140, items 7 and 8, above).

2160: Narratives

Narratives are an integral part of the basis upon which the State Controller's Office approves cost plans. After a county has identified the overhead and central support service programs that will be included in its cost plan, it must prepare an extensive narrative concerning each item. These narratives facilitate in-depth reviews of plans and enable the Controller's Office to respond to questions from grantor agencies and cost plan auditors. The importance of accurate and complete narratives in the cost plan cannot be over-emphasized.

The narrative for each central support service must include:

1. A description of the cost centers or functions within the service department and a concise summary of the extent to which each of these cost pools and/or functions provide services to other county departments;
2. A description of the types of costs that are considered to be allowable, an explanation of why these costs are allowable, and a discussion of the method or methods used to separate allowable costs from those costs considered to be unallowable;
3. A description of the allocation methods used to distribute costs in each cost pool and the source of the data used to distribute each cost pool's assigned expenditures; and
4. A description of the methodology used to identify any amounts billed to the user departments. The narrative for each schedule must include a specific identification of each revenue, interfund, and intrafund transfer received by the central support department whose expenditures are being allocated. If any of these resource inflows has not been used to reduce expenditure allocations, a complete explanation must be provided.

The narrative for each central support internal service fund (ISF) must include:

1. A complete, concise description of the ISF, including the types of costs incurred and the type and extent of all services provided;
2. A description of the components and methodology used to develop the billing rates charged to the benefiting departments, including the treatment of the overhead and central support service costs that pertain to the ISF;
3. A description of the accounting treatment used in clearing the over- or under-billings that may have resulted at fiscal year-end;
4. A copy of the ISF's financial statements for the most recent fiscal year, including the balance sheet, statement of cash flows, and statement of revenues, expenses, and changes in net assets;
5. If not provided in the audited financial statements, a complete analysis of the net assets and any transfers out for each ISF; and
6. Any additional information addressing ISFs required in other sections of OMB A-87, ASMB C-10, or this handbook.

The description of the ISF and the methodology used to develop billing rates (see paragraphs 2 and 3 above) need be submitted only when an ISF is first

established or when any information previously provided about that ISF changes. Audited financial statements, analyses of net assets, and explanations of transfers out for each central service ISF, however, must be included each year with the cost plan.

Whenever a county's organizational structure changes from that depicted in the organizational chart on file with the State Controller's Office, cost plan narratives must be accompanied with an updated organizational chart. The organizational chart should identify all county departments and illustrate their interrelationships, whether or not they are included as a service department in the cost plan.

2170: Documentation for Reviews and/or Audits

Each cost allocation plan should cover a single fiscal year and be based upon the actual financial and statistical data for a given fiscal year. This data and the narratives just discussed constitute the documentation necessary to support the cost plan and to substantiate its adequacy and accuracy. Each cost schedule will include, within the plan or attached to the plan, a supplementary schedule that clearly reconciles the allocated costs, revenues, and transfers in to county financial statements, as well as a description of the allocation statistics used to distribute the costs to the benefiting departments. Counties must maintain all cost plan supporting data on file, as prescribed in Section 2180.

2180: Record Retention Requirements

OMB A-87, Attachment C, Section G.5, states, "All central service cost allocation plans and related documentation used as a basis for claiming costs under Federal awards must be retained for audit in accordance with the records retention requirements contained in the Common Rule."

In Attachment A, Section B.7, of OMB A-87, "Common Rule" is defined as the "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments; Final Rule" originally issued at 53 FR 8034-8103 (March 11, 1988). DHHS uses the designation 45 CFR 92 for the Common Rule.

The Common Rule applies to all financial and programmatic records, supporting documents, statistical records, and other records that pertain to each countywide cost allocation plan. A three-year record retention period is imposed by the Common Rule. For the purposes of this handbook, this three-year period begins upon the date the State Controller receives the countywide cost allocation plan supported by the records.

If any litigation, claim, negotiation, audit or any other action involving the records has started before the expiration of the three-year period, all records that may be reasonably assumed to be relevant must be retained until completion of the action and resolution of all issues that arise from it, or until the end of the regular three-year period, whichever is later. Records that pertain to any non-expendable property upon which claims for federal reimbursement have been made must be retained for three years after final disposition of the properties.

2190: Access Rights

Agencies that award grants, and the State Controller's Office in its capacity as the cognizant agency for countywide cost allocation plans, have the right of access to any relevant books, documents, papers, electronic data, and other records that are pertinent to the cost plan in order to make audits, examinations, excerpts, and transcripts. The rights of access are not limited to the required retention period but continue as long as these records are retained.

These guidelines constitute the record retention policy for cost allocation plans only. Retention periods for financial, statistical, and other related information for any grant program are not addressed here. The grantee should contact the grantor agency and receive written permission before destroying any records pertinent to a grant program.

2195: Summary

In summary, adherence to the following basic concepts is vital when preparing the countywide cost allocation plan.

1. Complete knowledge of county organization is necessary, including familiarity with county structure, activities and operations performed, and the resources used to conduct county operations.
2. A working knowledge of federal requirements is desirable, including the costing principles contained in OMB A-87, ASMB C-10, and this handbook, as well as any program regulations or limitations established or imposed by grantor agencies.
3. The ability to support the cost plan with complete and accurate financial and statistical records is imperative. These records should be the products of an accounting system that has installed a comprehensive system of working checks and balances. Costs and credits should be treated properly and consistently. Any decisions or interpretations and the supporting rationale should be thoroughly documented. A clear, comprehensible, and complete audit trail must be maintained, linking the cost plan with all of the information used in its preparation.

Section 2200: Costs, Revenues, Reimbursements, and Other Credits

When developing the mechanisms that provide the data used in compiling a cost plan, it is imperative that the actual costs included in the cost plan are reconciled to the county's financial statements or actual costs as shown in the county's budget. A schedule showing this reconciliation must be included in the cost plan whenever the relationship between the two is not apparent. The costs allocated through a cost plan must be net of all revenues, reimbursements, and other credits applicable to any particular cost center.

2210: Allowable Income (Revenue)

Central service or program income may include income (revenue) from fees for services performed, from the use or rental of real or personal property, and from the sale of real property, equipment, and/or personal property. Income from taxes, special assessments, levies, fines, and other revenues may not be included unless such revenues are specifically identified as program income in a grant agreement or in federal agency regulations.

2215: Applicable Credits

Applicable credits refer to those receipts or reductions of expenditures that offset or reduce allocable costs to county operating departments as direct or indirect costs. Examples of such transactions include: purchase discounts, rebates, or allowances; recoveries or indemnities on losses; sale of publications, equipment, and scrap; income from personal or incidental services; adjustments of overpayments or erroneous charges; and charges for services.

As indicated in OMB A-87, Attachment A, Section C.4, applicable credits may also arise when federal funds are received or are available from sources other than the grant program and are used to finance operations or capital items of the grantee. This includes costs resulting from the use or depreciation of items donated or financed by the federal government to fulfill matching requirements under another grant program. In determining the rates or amounts applicable to a given grant, applicable credits should be used to reduce related expenditures.

2220: Examples of Applicable Credits

Prior to expenditure allocation, any particular credit for a service that cannot be attributed directly to a specific benefiting department or agency must be deducted from the total costs of the department or cost center that provided the service. If a credit can be identified to a particular department or agency, it should be deducted from the total allocations to that department or agency. Following are examples.

1. A county maintains its workers' compensation insurance with the State Workers' Compensation Insurance Fund. Any premium reimbursements received from this fund would be used, prior to allocation, to reduce the current premium charges. If, however, the reimbursements pertain to a portion of the premium charged to a *specific* department, such as public works, then the credit should be applied only to that department.
2. For a fee, the county auditor-controller's staff conducts audits for a local school district. This revenue should be deducted from the auditing cost center's cost allocation to the school district.

3. For a small charge per copy, county employees and the general public may use county photocopy machines for personal business. This revenue constitutes an incidental service and, prior to the allocation process, amounts collected should be prorated to the applicable department's cost pools and deducted from that department's costs.
4. A county's graphic arts department allows one of its illustrators to prepare drawings and illustrations for a monthly employee union newsletter. The union pays for these services when they are performed on county time and at county expense. The revenue received would be considered recompense for a personal service and deducted from the total cost of the department prior to allocation.
5. A county department conducts a conference to disseminate information on new grant procedures and regulations. The attendees, grant participants and sub-grantees, pay a registration fee for attendance. All fees collected must be deducted from the costs of the conference before reimbursement can be claimed from the grantor agency.
6. Several automobiles have been purchased for use in the county's social services department using grantor agency and county matching funds. Should some other grantee program use one of the autos, this second program would not be able to claim reimbursement from its grantor agency for the use or depreciation of the car because it had already been acquired with federal and/or matching funds. This would also be true if a service department used one of these cars. Because these vehicles were acquired with federal and other matching funds, a service department would not be able to include use or depreciation charges for these cars in the total costs that it allocates to other departments.
7. A department has employees who are funded through a federally reimbursed employment program. If this is a central services department, reimbursed salaries and benefits must be removed prior to allocation of the department's costs. If the department is an operating department, previously reimbursed costs cannot be included in any federal or state claim for reimbursement.

2230: General Billing Requirements

Counties must meet certain requirements in developing the billing mechanisms for departments charging for services. Any ISF or central support services budget unit that bills for its services must provide:

1. A description of the types of services provided and their relevance to federal and state programs conducted by the county;
2. The items of expense included in the cost of each service;
3. Identification of the departments that received services;
4. A concise and complete description of the method used to develop the billing rate or rates used in charging for services; and
5. A concise and complete description of the accounting treatment and method of adjusting any over/under-recovered costs at fiscal year-end.

Unless approved in the current Cost Plan Negotiation Agreement concluded between the county and the State Controller, county departments may not claim reimbursement for direct billings from grantor agencies.

Counties may directly charge operating departments for OMB A-87 central support services that have been allocated to them in the cost plan. If these cost plan charges are not applied to reduce cost plan allocated costs, controls must be put in place to ensure that the amounts charged are not claimed as direct costs on any grant claims for reimbursement. The practice of directly charging OMB A-87 allocations must be fully explained in cost plan narratives.

2235: Internal Service Funds (ISFs)

Cost plans should treat proprietary funds as operating departments when allocating indirect costs. Governmental Accounting Standards Board Statement Number 34 (GASB 34) identifies two types of proprietary funds – enterprise funds and internal service funds (ISFs). It notes that proprietary fund reporting focuses on the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. GASB 34 states that internal service funds may be used to report any activity that provides goods or services to other funds, departments, or agencies of the primary government and its component units, or to other governments, on a cost-reimbursement basis. Internal service funds should be used only if the reporting government is the predominant participant in the activity. Otherwise, the activity should be reported as an enterprise fund.

The charges by each ISF attempt to recover sufficient revenues to fund all of the costs associated with providing goods and/or services, including indirect (allocated) costs. An ISF's objective is not to make a profit but to recover, over a period of time, the total costs of providing goods or services. The State Controller's *Accounting Standards and Procedures for Counties* requires ISF rates and billings for goods and services to be cost based, employing an approved cost accounting and/or cost allocation system. Such a system will supply information beyond that supplied by a county's general accounting records but will reconcile to those records. All users of an ISF should be billed directly in order to ensure equitable charges to all units that have received the ISF's goods or services. If all users are not equitably billed, the fund must prepare a schedule reconciling actual charges to the amounts that should have been charged in an equitable system.

2240: Adjusting ISF Billing Rates

Each ISF should regularly prepare and examine its financial condition at least midway through each fiscal year. If a material profit or loss is projected for the end of the fiscal year, the fund's billing rates should be adjusted during the year. An immaterial deficit or profit at year-end should be offset by adjusting the billing rates for the following fiscal period. ISFs should not produce any significant profit or loss in the long run. An ISF's billing rates should be designed to recover the entire cost of its operations, including the indirect overhead and central support service costs identified in the cost plan. These costs should be charged to and paid by the ISF as part of its ongoing operations costs. All cost plans should treat ISFs as operating departments when allocating indirect costs.

2245: ISF Net Assets

Each central service activity, including proprietary funds, must separately account for all resources received by the service (including imputed resource gains), expenses incurred by the activity to furnish goods and services, and profit and/or loss. The differences between assets and liabilities are net assets. Net assets should be reported in three categories: “invested in net assets, net of related debt (and accumulated depreciation)”; “restricted”; and “unrestricted.” Net assets should be reported as restricted only when constraints are placed upon them either externally, as imposed by creditors, grantors, contributors, or laws or regulations of other governments, or when imposed by law, through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.” Portions of unrestricted net assets may be “designated” to indicate that the management of the ISF does not consider these assets to be available for general operations. In contrast to restricted net assets, designated unrestricted net assets are only constrained internally by a fund’s management, which may remove or modify the designations.

ISFs may include in their rates depreciation charges intended to recapture the original cost of a vehicle or other piece of equipment. Depreciation must be charged straight-line over a reasonable equipment life. Normally, equipment life is determined by applying the Internal Revenue Service Alternative Depreciation System (straight-line) recovery periods. Deviations from these recovery periods must be supported by detailed analysis. Depreciation charges collected must be matched to the individual items of equipment for which the depreciation was charged and must be discontinued when an item of equipment is fully depreciated. Amounts collected as depreciation charges for an item of equipment must be made available for expenditure when that piece of equipment is replaced or removed from service. ISFs may impose a replacement charge in their rates to compensate for estimated increases in the cost of equipment purchased. Replacement/inflationary charges may not be claimed for reimbursement by grant departments. Amounts charged above the original cost of equipment must be removed from the rates charged to grant departments or specifically identified to these departments so that they are not included in requests for grant reimbursement. Estimated replacement/inflation charges must be re-evaluated and adjusted no less frequently than annually.

In addition to the full recovery of costs, charges by an ISF may provide for the establishment and maintenance of a reasonable level of working capital reserve. Unrestricted, undesignated net assets up to the amount required to pay for 60 days of average cash expenses are considered a reasonable working capital reserve. Each year counties must provide a thorough analysis of the net assets held by each of their central service ISFs at the end of the cost plan’s base year. It is important that counties fully report their unrestricted net assets and describe the portions of these assets that are designated, so the acceptability of each ISF’s working capital may be evaluated during the desk review of the county’s cost plan. If an ISF’s working capital chronically exceeds the amount established as allowable by OMB A-87, the ISF will be deleted from Section II, Costs Distributed Through Billing or Cost Transfer Mechanisms, of the county’s negotiation agreement and grant agencies will no

longer be authorized to claim reimbursement for charges that were imposed by that ISF. The rationale and methodology for the designation of net assets must be fully supported and auditable. Transfers, reclassifications, or expenditures of any central support net assets reported to SCO as reserved or designated for any purpose other than the purposes for which these assets were designated or reserved must be approved by the Controller's Office Cost Plan Section.

2250: ISF Loans

An ISF may make loans only to other county funds, subject to the following restrictions:

1. The loan must be recorded as an account receivable in the ISF's financial records;
2. The loan must be repaid with interest, and the interest computed at the same rate that the ISF could have earned had the loan not taken place;
3. The period of the loan must not exceed 36 months;
4. The loan must not impact adversely on the ISF's current cash requirements;
5. The loan must be included in the measurement of the ISF's assets for any actuarial purposes; and
6. The loan agreement must include a clause that permits the ISF to demand accelerated repayment of all or any part of the loan if its cash requirements so dictate.

If a loan made by an ISF is not fully repaid by the end of the loan period, the loan is regarded as a "bad debt" and requires an immediate rebate to all grant programs from the county general fund.

2255: Self-Insurance Funds

OMB A-87, Attachment C, Section E.3.c., requires that counties provide the following information to the State Controller whenever a self-insurance fund is included in a county cost plan or when departments or agencies claim reimbursement for self-insurance charges:

1. A fund balance sheet;
2. A statement of revenues, expenses, and changes in net fund assets or fund equity, including a summary of billings and claims paid by the fund;
3. A listing of all non-operating transfers into and out of the fund;
4. The type or types of risks covered by the fund;
5. An explanation of how the level of fund contributions is determined, including a copy of the current actuarial report (with the actuarial assumptions used if the contributions are determined on an actuarial basis); and
6. A description of the procedures used to charge or allocate fund contributions to benefited activities.

The board of supervisors of a county may, by resolution, establish and maintain a reserve account to insure against its liability or the liability of its employees for injuries or property damages, for liability under the workers' compensation laws, for casualty losses sustained by the county, and for

providing health and welfare benefits for its employees. Reserves maintained by county insurance funds may be no greater than the amounts recommended by the county's actuaries. Contributions to reserves must be based upon sound actuarial principles using historical experience and reasonable assumptions. All insurance reserve levels must be analyzed and updated no less frequently than once every two years.

2260: Distribution Formula

Charges for liability and for workers' compensation insurance contributions and/or expenses must be distributed to departments/funds employing a combination of 60% to 80% experience and 40% to 20% exposure for each type of coverage. The loss history used each year should consist of losses for the five to seven most recent years and should be reviewed and updated at least annually. Losses charged to departments and/or funds may be limited to a maximum amount (capped) as long as these losses are treated uniformly and consistently. Please see Section 4280, Risk Management Cost Identification Systems, page 118, for further discussion.

Insurance reserve levels and loss histories should be derived using claims:

1. Paid;
2. Submitted and adjudicated but not paid;
3. Submitted but not adjudicated; and
4. Incurred but not submitted (these amounts must be identified and explained).

2265: Probable Incurred Liability

Claims submitted but not adjudicated and claims incurred but not submitted should be recognized if it is determined that it is probable that a liability for each such claim has been incurred and if the amount of the loss can be reasonably estimated. If there is a potential range of losses for a claim, the most likely amount of the loss should be selected. If no single amount within a probable range of losses is most likely to occur, the minimum value in this range should be recorded as the expected loss. Information on claims submitted but not adjudicated and claims incurred but not submitted must be reviewed and updated as additional information becomes available.

2270: Central Support Budget Units

Central support budget units transfer their expenditures completely or partially to other budget units through direct charges. The residual unbilled expenditures represent costs that have not been reimbursed and that can be allocated in the cost plan, along with any indirect overhead associated with the unit. Indirect overhead allocations should be based upon the original charges to the user departments.

The methodologies used to develop the amounts charged to user departments must be consistently applied to all departments charged.

2275: Partial Direct Billing

There may be times when it is impractical to directly charge all user departments. In such instances, partial direct billing is permitted for grant reimbursement purposes. Costs must be equitably allocated to all benefiting departments, and amounts directly charged to any departments must be applied to reduce the associated allocation to these departments.

Over two or more fiscal periods, no user department may be consistently and materially overcharged. If any department, grantee or otherwise, is consistently and materially overcharged, the county will be required to either revise its method of developing charges to a methodology approved by the State Controller's Office or discontinue direct charging. Failure to rectify overcharges will result in denial of claims for reimbursement for these direct charges.

Federal costing principles prohibit costs allocable to one user department from being shifted to another user department.

Billing rate methodologies used should result in fair and equitable charges that are consistently applied to all users of the service. No program or department may be burdened with charges that are identifiable to other programs or departments.

2280: Memo Billing

The specific relationship of billings between a county's central support and operating departments is an area over which the State Controller has cognizance. Because "memo billing" presents the potential for an accidental duplication of recovery, the State Controller prohibits its use.

Memo billing refers to the practice of one county department providing goods or services to another and identifying the costs to the receiving department only via interdepartmental correspondence. The goods or services may be of a countywide support nature or used solely in the performance of a specific element of a grant program. The absence of journal entries, recording the transfer of costs, in the accounting records of either the servicing or the receiving department distinguishes memo billings from direct billings or intrafund transfers.

Memo billings become a matter of concern to the State Controller's Office when goods and/or services are provided between a service and a grantee department. For example, the county Department of Collections notifies, or "memo bills," the county Family Support Division for collection services provided by the department of collections with a value of \$50,000 during a fiscal year. Family Support claims the "memo bill" amount as a direct cost. When the cost plan for the same fiscal year is prepared, the \$50,000 will be directly identified and included in the allocation of costs to Family Support. No credit adjustments will be included in the Countywide Cost Allocation Plan to offset this allocation because the "memo bill" amount was never recorded in the accounting records. As a result, OMB A-87 costs identified to Family Support in the cost summary/exhibit will include an amount that has been previously claimed as a direct cost. This duplication is unallowable for grant reimbursement purposes.

2290: Allowable Necessary Costs

The State Controller's cognizance, however, extends only to the matters addressed in OMB A-87, ASMB C-10, this handbook, and associated principles and policies. At times, other county operating departments may undertake various functions of a grant program under a cooperative, interagency, or memorandum type of agreement. If these "services" relate

directly to the grant program, they should be considered direct costs of the total grant program, whether or not they are billed to the grant department.

As long as these costs are recorded on the accounting records of the county, represent actual identified costs, are identified by a cost accounting system or a departmental indirect cost proposal, and/or are substantiated by cost records, they are acceptable as direct costs of the grant program. Such costs may be claimed for reimbursement regardless of the budget unit in which they are recorded. The guiding standard is that the grantor agency fund the costs associated with a particular grant program, not specifically the costs of a particular budget unit. A necessary cost of a grant program is allowable regardless of where it is incurred within a county government organization.

OMB A-87 cost principles do not specify a particular form of organization, management technique, or method of accounting as a condition for cost reimbursement for federal grants and contracts. Consequently, the accumulation and claiming of direct costs by recipient agencies are matters that must be agreed upon between grantor and grantee agencies.

Exhibit 2201

Cost Plan Terminology

Listed below are the definitions for a number of key words that could affect the preparation of a cost plan. For additional definitions, refer to OMB A-87, Attachment A, Section B, and to OMB A-87, Attachment B.

Billing	The system whereby the costs of providing a particular service or benefit are accumulated and charged to the receiving department, fund, or entity.
Cost	The assigned value of goods or services denominated in dollars.
Cost Accounting	The method of accounting that provides for the accumulation and recording of all the elements of cost incurred to accomplish a purpose, to carry on an activity or operation, or to complete a unit of work or a specific job.
Cost Accounting System	The term used to describe the system that provides for the implementation of cost accounting. Cost accounting systems may be manual, partly automated, or fully automated.
Cost Analysis	The process of determining the cost of a particular operation or service by analyzing the financial and cost records, but without formally recording the results in cost ledgers, as in a cost accounting system. Cost analysis is an essential component of cost allocation methodology.
Cost Applied (Process)	Please see Intrafund Transfers.
Cost Ledger	The term used to describe the subsidiary record in which various operations and/or services are posted in detail. Such accounts should be arranged and kept so that the results shown in them may be summarized in a control account. Cost records must be reconciled to and verified by a control account or accounts in the general ledger and/or object expenditure records.
Cost Records	All ledgers, supporting records, schedules, reports, invoices, vouchers, and other records and documents that reflect the cost of projects, jobs, production centers, processes, operations, products, or services, or the costs of any of the component parts.
Cost Unit	The term used in cost accounting to designate the unit of product or service whose cost is computed. These units are selected for the purpose of comparing the actual cost with a standard/budgeted cost or with actual costs of units produced under different circumstances or at different places and times.
Departmental Indirect Cost Rate Proposal (ICP or ICRP)	The method used to distribute the countywide OMB A-87 costs plus departmental administrative costs to the various programs within a department. Often, a rate applied to direct program costs is used.
Direct Billing (Process)	The process whereby one entity charges another for the cost of specifically identified goods or services. Direct billings may result in revenues, interfund transactions, or intrafund transfers, depending upon whether the payments received for direct billings are received from non-governmental agencies, other

	governmental funds and agencies, or other budget units that are included in the fund providing the goods or services. The goods and/or services furnished and the related income realized must be completely documented. Any income from direct billings for costs that are also allocated through the cost plan must be either credited to the entities from which the income was derived or used to reduce total cost plan expenditures.
Direct Costs, Expenses, and Expenditures	Reductions in assets that are traceable to specific goods, services, units, programs, activities, or functions. Direct costs/expenses differ from indirect costs/expenses. Indirect costs/expenses cannot be specifically traced and must be allocated on some systematic and rational basis.
Expenditures	Reductions in the net financial resources of a fund. This term is used to describe the outflow of financial resources in a fund that employs the modified accrual basis of accounting.
Expenses	Outflows or other expending of assets or incurring of liabilities or a combination of both from delivering or producing goods, rendering services, or carrying out other activities that constitute an entity's ongoing operations during a set period. The term applies to activities that diminish the economic position of entities and is used by funds that employ the accrual basis of accounting.
Flow of Economic Resources	All assets available to a government unit for the purpose of providing goods and services. This classification refers to the accrual basis of accounting that is used by proprietary funds (internal service funds and enterprise funds).
Flow of Total Financial Resources	All of the monetary assets and monetary liabilities that arise from operations. This measurement focus is used in modified accrual government financial reporting.
Indirect Costs (Overhead)	The elements of cost necessary in the production of a good or service that are not directly traceable to the product or service. Usually these costs relate to objects or expenditures that do not become an integral part of the finished product or service, such as rent, heat, light, supplies, management and supervision.
Interfund Transactions	<p>Transactions that occur between funds of the same government reporting entity. They include:</p> <ol style="list-style-type: none"> 1. Interfund Loans - Loans made by one fund to another. 2. Operating Transfers - All interfund transfers other than residual equity transfers (e.g., legally authorized transfers from a fund receiving revenue to the fund through which the resources are to be expended). 3. Quasi-External Transactions - Interfund transactions that would be treated as revenues, expenditures, or expenses if they involved organizations external to the government unit. Such transactions include: payments in lieu of taxes from an enterprise fund to the general fund; internal service fund billings to departments; routine employer contributions to a pension trust fund; and routine service

charges for inspection, engineering, utilities, or other services provided by a department financed by one fund to a department financed by another fund. In the funds involved, these transactions should be accounted for as revenues, expenditures, or expenses.

4. **Reimbursements** - Repayment of amounts remitted on behalf of another party; or interfund transactions that constitute reimbursements of a fund for expenditures or expenses initially made from it that properly apply to another fund. For example, an expenditure properly chargeable to a special revenue fund is initially made from the general fund and is subsequently reimbursed. These transactions are recorded as expenditures or expenses (as appropriate) in the reimbursing fund and as reductions of the expenditures or expenses in the fund that is reimbursed.
5. **Residual Equity Transfers** - Nonrecurring or non-routine transfers of equity between funds. For example, contribution of enterprise fund or internal service fund capital by the general fund, subsequent return of all or part of such contribution to the general fund, and transfers of residual balances of discontinued funds to the general fund or a debt service fund.

Interfund Transfers

All interfund transactions except loans, quasi-external transactions, and reimbursements. Interfund transfers can be classified as belonging to one of two major categories: operating transfers or residual equity transfers.

Intrafund Transfers

Transactions between a primary government and its blended component units, or transfers among the blended units of a government fund. This handbook uses the term primarily to describe transfers between operating and central support budget units of the general fund. Intrafund transfers are sometimes referred to as cost applied. This process consists of a transfer of all or part of a budget unit's costs to other budget units in the same governmental type fund. This is accomplished by reducing expenditures in budget units to which the expenditures were originally charged and increasing the corresponding expenditures in other budget units of the same fund to which these expenditures actually apply. Intrafund transfers that are a consequence of direct charges for services must be clearly and completely described and accounted for by budget unit, so they may be properly applied to cost allocations.

Memo Billing

Values assigned to goods and services that are not recorded on a county's accounting records. The value of the goods or services provided by one department to another is indicated by interdepartmental communication; however, the charge is not recorded in the general journal, the expenditure ledgers, or in any other accounting record. The State Controller does not permit costs supported by memo billings to be applied in any aspect of cost plan preparation or application. If these billings are used internally for some purpose other than cost assignment between central support service and operating departments, they must be supported by cost analysis and detailed cost records.

Program Cost

A cost associated with providing a particular service or activity. Program costs may be direct or indirect.

Revenues

1. Increases in the net current assets of a government type fund, from other than expenditure refunds, capital contributions, operating transfers, and residual equity transfers. General long-term debt proceeds and transfers in are classified as “other financing sources” rather than revenues.
2. Increases in the net total assets of a propriety type fund, from other than expense refunds, capital contributions, operating transfers, and residual equity transfers.

Unit Cost

The cost of producing a unit of product or rendering a unit of services (e.g., the cost of performing a tune-up on one sedan).

Work Unit

The term used to describe a fixed quantity that will consistently measure work effort expended in the performance of an activity or the production of a good.

Section 2300: Allowable Compensation for Personnel Services

Allowable compensation for personnel services is extensively addressed in OMB A-87, Attachment B, Section 11, and ASMB C-10, Sections 3-5 through 3-24, as well as in this handbook.

Allowable grant program costs for personnel services are comprised of costs directly associated with the program and costs indirectly associated with the program through the central support service departments identified in the countywide cost allocation plan.

2310: Required Supporting Documentation

OMB A-87, Attachment B, Section 11.h., discusses the supporting documentation requirements of charges claimed for salaries and wages. It imposes the condition that charges to federal awards for salaries and wages, whether treated as direct or indirect costs, be based on payrolls documented in accordance with the generally accepted accounting practice of the government unit and approved by a responsible official or responsible officials of the government unit. All salaries and wages included in the cost plan must meet this minimum requirement. Additionally, because many different grant programs are found in counties, each set of grant regulations should be reviewed to determine if there are additional payroll or time documentation requirements.

Charges for the salaries and wages of employees working solely on a single federal award or cost objective must be supported, at a minimum, by periodic certifications that the employee worked only on that program for the period covered by the certification. These certifications must be prepared at least semi-annually and must be signed by the employee and a supervisory official having first-hand knowledge of the work performed by the employee.

Employees who work exclusively in a single indirect cost pool must each sign their normal payroll documentation. Each employee's supervisor must formally approve the employee's time report. No further documentation is required for cost allocation purposes.

Exhibit 2301, page 66, provides examples of time-reporting requirements for various personnel positions.

2320: Personnel Activity Reports

When employees work on two or more activities or cost objectives and/or when their activities are directly identified or directly billed to particular budget units or agencies, the distribution of their salaries or wages must be supported by personnel activity reports.

Exhibit 2302, page 67, is an example of a personnel activity report, completed daily and summarized on a monthly basis. It tracks all time spent on projects of a specific nature as well as those activities that are continuous or ongoing by nature. Personnel activity reports may be maintained either electronically or manually. In all cases, to be acceptable as documentation for personnel services, all personnel activity reports must:

1. Reflect an after-the-fact distribution of each employee's actual activity;
2. Account for the total activity for which each employee is compensated;
3. Provide full and complete substantiation of the distribution of effort and support the imposition of any direct charges for services;
4. Be prepared at least monthly, and fully account for the total labor hours of each month;
5. Be signed and dated by the employee not later than the end of the pay period that follows the pay period covered by the report; and
6. Document, by signature or initials and date, after-the-fact supervisorial review and approval of each activity report.

"Electronic signatures" are acceptable if a department that uses automated time reporting can prove that only the actions of the individual preparing a personnel activity report would produce entries on that report or the report includes a digital signature that identified a unique individual as the preparer of the electronic report. Such reports require physical or unique electronic documentation of supervisorial review and approval.

Counties are encouraged to use a personnel activity reporting system, as described above, for employees in all departments, including those departments performing duties considered to be unallowable for grant reimbursement purposes. Reporting in a format such as this is mandatory for any employee who works on multiple activities or cost objectives, whose activities are indirectly identified to a particular activity and/or activities, or whose efforts are directly billed.

2330: Acceptable Substitute Systems

Substitute systems for allocated salaries and wages are acceptable if the county can demonstrate that such substitutions are statistically valid and if these substitute systems are approved by the State Controller's Office prior to being implemented.

In order to be statistically valid, statistical sampling requires that the population selected for examination be a complete population. The sampling must also meet the following requirements.

1. All employees whose salaries and wages are to be allocated for the accounting period under examination must be included.
2. The entire period involved must be covered by the sample.
3. The sampling units must be selected from the defined population so that each sampling unit has a chance of being selected.
4. There must be a known probability of selection.
5. The sample must be selected randomly and apply to the period being sampled (see ASMB C-10, Part III, Section 3-23).
6. The means of determining the sample size must be quantified.
7. The sample results must be mathematically evaluated.

2340: Purpose of Documentation

Direct charges, direct identification of effort, and allocation of professional and nonprofessional salaries and wages in cost plans must be supported as detailed in Sections 2310 and 2320, page 63. The fundamental purpose for this

documentation of time applied is to obtain the requisite specificity to ensure that efforts expended are accurately identified to cost pools and/or individual departments and that charges for services supplied are entirely supported. This is particularly important when individuals work in departments that may perform both allowable and unallowable functions, work on more than one federal award, work on both federal and non-federal awards, work on an indirect cost activity and a direct cost activity, work on two or more indirect activities that are allocated using different allocation bases, or work on an unallowable activity and an allowable direct or indirect cost activity. Additionally, each cost plan schedule's general and administrative expenditures are distributed to the other cost pools in that schedule using these cost pools' salary and wages expenditures.

Any and all exceptions to these standards for cost plan and direct billing time distribution documentation must be formally requested and approved in advance by the State Controller's Office.

2350: Summary

The above guidelines constitute the minimum substantiation required if salary and wage information is to be included in cost plans approved by the Controller's Office. Counties are encouraged to implement more extensive documentation, in the form of 100% continuous time studies for all activities. It is the prerogative of each county, however, to determine if the costs of collecting the personnel service information exceeds the reimbursement that will be realized from the inclusion of the costs of these services in their cost plans or direct billings.

Exhibit 2301

Examples of Time-Reporting Requirements

<u>Department</u>	<u>Position</u>	Minimally Acceptable Time-Reporting Records
County Administrative Office	Administrative Analyst working only on budget issues for the county departments	Payroll records documented in accordance with generally accepted accounting standards and approved by the employee's supervisor
Auditor-Controller's Office	Accounting Technician providing services only to the county's Social Services Department	Payroll records and certificates completed at least after each six-month period, signed by the employee's supervisor
Auditor-Controller's Office	Accountant performing duties that may be assigned to more than one cost pool	Payroll records and after-the-fact personnel activity reports prepared at least monthly, accounting for total reimbursed activity, completely substantiating the distribution of effort, signed by the employee, and approved by the employee's supervisor.
County Counsel's Office	Lawyer whose services are directly charged or directly identified to one or more county departments	Payroll records and after-the-fact personnel activity reports prepared at least monthly, accounting for total reimbursed activity, completely substantiating the distribution of effort, signed by the employee, and approved by the employee's supervisor.

Section 2400: Allowable and Allocable Support Service and External Overhead Costs

The total costs of the operations of county departments are comprised of direct and indirect costs. Allowable direct costs plus allowable indirect costs net of all revenues, reimbursements, and credits make up the total costs that may be reimbursed by federal and state governments. Allowable costs in the context of a countywide cost allocation plan consist of the direct and indirect costs that are considered to be eligible for reimbursement under the provisions of OMB A-87 or that are specifically authorized by the terms of a particular federal or state grant. If a cost benefits a grant program and can be identified to that program, it may be included with all other direct costs of that program for grant reimbursement purposes unless it is specifically prohibited or limited by law or other governing directive. Indirect costs, although they may not be readily assignable to cost objectives because they benefit more than one cost objective, must provide specific benefit to each of the cost objectives to which they are allocated.

2410: Classifying Costs

There are no universal rules for classifying costs as either direct or indirect. A cost may be direct with respect to some specific service or function and may also be indirect with respect to a federal award or some other final cost pool. However, each item of cost should be treated consistently in like circumstances either as a direct or an indirect cost.

OMB A-87, Attachment A, Section F, Paragraph 1, defines indirect costs as those costs:

1. Incurred for a common or joint purpose benefiting more than one cost objective; and
2. Not readily assignable to the cost objectives specifically benefited, without effort that is disproportionate to the results achieved.

Paragraph 1 continues:

The term "indirect costs," as used herein, applies to costs of this type originating in the grantee department, as well as those incurred by other departments in supplying goods, services, and facilities. To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect costs within a governmental unit department or in other agencies providing services to a governmental unit department. Indirect cost pools should be distributed to benefited cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.

2420: Allowable Activities

Listed below are examples of some general county activities that constitute allowable expenditures for allocation.

1. All phases of the budgeting process are considered allowable, including preparation, presentation, and recording of the budget in the appropriate accounts, since all phases are considered to be

necessary for proper and efficient cost control in accounting for grant programs.

2. General accounting procedures, which include the costs of recording expenditures in the accounting records and matching them against appropriations, are an integral part of maintaining central accounting records and are allowable. This is a component of internal control and is necessary for the proper and efficient administration of grant programs.
3. Audit services are allowable, provided the audits were performed in accordance with the Single Audit Act. Generally, the percentage of costs charged to federal awards for a single audit shall not exceed the percentage derived by dividing federal funds expended by total funds expended by the recipient or sub-recipient (including program matching funds) during the fiscal year. This percentage may be exceeded only if appropriate documentation demonstrates higher actual costs. Other audit costs are allowable if they are specifically required by the terms of a federal or state grant, approved by the State Controller as a direct cost to an award, or included as an indirect cost in a cost allocation plan or rate.

The costs of collecting the information supporting a cost included in the cost plan must be measured against the return that will be realized by the inclusion of that cost in the plan. Personnel preparing cost plans must explain in the narratives that accompany each plan why certain costs were treated as allowable or unallowable.

2430: Interpreting Allowable Costs and Activities

Questions often arise as to what costs are allowable, what costs benefit grant departments, and what activities should be considered as general government. Among the units where ambiguities may occur are the departments of the county administrative officer, the auditor-controller, the treasurer-tax collector, and the county counsel. The following general guidelines may be helpful when determining if various central support functions are allowable.

Allowable costs are usually administrative or supportive in nature and the benefits associated with them flow into an organization, as described in OMB A-87, Attachment A, Section C. Allowable functions include activities that are required by or provide specific benefits to federal and/or state programs or other county departments. Some examples are:

1. Services provided in response to requests from other county departments;
2. Reports to the county board of supervisors regarding the county budget or county operations; and
3. Functions, identified by time studies, that directly benefit grant programs or are identified to departments or activities that are necessary and reasonable for proper and efficient administration of grant programs. These functions may be allocated to such programs under principles outlined in OMB A-87, and constitute costs that

may be included in a countywide cost allocation plan. Details of allowable costs are presented in OMB A-87, Attachment B.

2440: Unallowable Costs and Activities

Unallowable activities include activities not affected by the existence of federal and/or state programs or the operation and administration of county departments. These costs do not provide specific benefits to any cost objectives. Examples are:

1. Services performed at the request of the board of supervisors;
2. Reports to the board regarding the effect of proposed operations on overall county tax rates;
3. Activities that cannot be identified with a grant program and that do not benefit any grant programs;
4. General functions that are required to carry out the overall responsibilities of state or local governments but do not benefit any grant programs;
5. Purchase of alcoholic beverages;
6. Bad debts;
7. Contingencies;
8. Contributions;
9. Defense and prosecution of criminal and civil proceedings and claims;
10. Depreciation of land, any portion of buildings and equipment purchased by grant funds, or any buildings and equipment acquired as a part of a matching requirement;
11. Entertainment;
12. Fund raising and investment management, generally;
13. General government expenses (see OMB A-87, Attachment B, Section 23);
14. Idle facilities and idle capacity;
15. Interest on funds not loaned by a bona fide third party;
16. Lobbying; and
17. Self-assessed taxes.

Any excess costs over the federal contribution under one award agreement are unallowable under other award agreements.

2450: Factors Affecting the Allowability of Costs

The allowability of different expenditures will vary due to circumstances or specific conditions of grant agreements. It is imperative that OMB A-87, Attachment B, ASMB C-10, and this handbook be carefully reviewed prior to including any expenditures in the cost plan. Any questions about the acceptability of any expenditure item or category should be resolved in consultation with the State Controller's Office.

Many allowable costs included in the cost plan are readily identifiable to those departments that benefit from the service activity. Examples are:

1. Utility costs and janitorial work charged to a county building and allocated to building occupants using the number of square feet of occupancy;
2. Personnel costs distributed using the number of employees per department;
3. Warrant processing costs allocated by the number of warrants issued; and
4. Auditing costs assigned on the actual time spent auditing each department.

2460: Allocable Costs

Some costs are not readily assigned. In general, these costs are incurred on behalf of the county and are allocable to particular cost objectives if the goods or services involved are chargeable or assignable to these cost objectives in proportion to the relative benefits received. Such costs must be allocated using a base that reflects the service that they provide. All activities that benefit from a governmental unit's indirect costs, including unallowable activities and services donated to the governmental unit by third parties, must receive an appropriate allocation of indirect costs. Any cost allocable to a particular federal award or cost objective under the principles provided for in OMB A-87 may not be charged to other federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or by terms of federal awards, or for any other reasons. This prohibition does not preclude governmental units from shifting costs that are allowable under two or more awards in accordance with existing program agreements. When a determination is made as to what base will be used to allocate costs, the following points should be considered.

1. The allocation base must reasonably reflect the level of service received by all county departments benefiting from the activity.
2. There must be a direct causal relationship between the allocation base used and the service provided.
3. The allocation base must be auditable and supported by information kept on file in the county.

2470: Choosing an Allocation Base

It is difficult to prescribe specific bases to be used in allocating central support service activities. Within the different California county organizational structures, there exists a range of acceptable allocation bases for each service activity, ranging from simple to complex. For example, the expense of cost plan preparation is considered allowable for grant reimbursement purposes. This activity benefits departments that claim or have a potential to claim reimbursement for grant programs and departments that bill other county departments, outside agencies, or the general public for services rendered. It permits the assignment of full operational costs, including overhead, to various county departments. Allocation bases selected should reflect this service relationship and could include:

1. Proportionate allocation to all benefiting departments, including general fund and ISF service departments, based upon benefits identified in the cost plan base year period;

2. Allocation to all benefiting departments based upon total departmental expenditures, adjusted to exclude fixed assets, flow-through funds, and large contracts;
3. Allocation to all central support service units, using total expenditures adjusted to exclude fixed assets, flow-through funds, and large contracts; and
4. Allocation to all central support service units based upon actual time spent in each central support service department.

All of the methods of assigning the costs of preparing a cost plan constitute appropriate allocation methodologies and serve to illustrate the complexities involved in prescribing just one base to be used for allocations. What may be an appropriate allocation base for one county with a comprehensive accounting system may be too complex or cumbersome for use in a small county with limited resources to capture and categorize data. The intent of OMB A-87 is to provide a means of identifying the indirect and support service costs related to grant programs without imposing upon grantees the requirement to maintain formal cost accounting systems.

2480: Summary

In summary, when an allocation base is required to distribute a given service cost, a base should be selected, utilizing statistical information, that can be compiled without prohibitive costs and that provides a direct causal relationship between the allocation method used and the expenditures allocated.

Section 2500: Depreciation and Use Allowances

Depreciation and use allowances are two methods of allocating the cost of fixed assets to specific time periods in which the county benefits from the use of the assets.

2510: Depreciation Defined

Depreciation is used to allocate the cost of fixed assets throughout their useful life. Depreciation must be based upon the actual cost of the asset, not upon its replacement value. Accelerated depreciation is not allowed; only straight-line depreciation may be used. The useful life of any asset is that established for the applicable class of assets in Internal Revenue Service guidelines for straight-line depreciation, unless a county can propose a reasonable, objective, and independently derived alternative schedule. If a government unit changes from use allowance (see below) to depreciation, depreciation expense for each asset in the class being depreciated must be computed as though the depreciation had been charged from the original date of acquisition.

2520: Use Allowance Defined

When a government unit claims a use allowance for a category of fixed assets, a standard percentage of the total cost of each fixed asset in this category may be claimed each year that the asset is in use. Six and two-thirds percent of the total acquisition cost of each piece of equipment and two percent of the total capitalized cost of each building may be claimed.

2530: Depreciation and Use Allowance Conditions

All assets of a single class must be treated in the same manner. Complete property records must support all use allowances or depreciation charges. Physical inventories must be taken at least every two years. Depreciation records must show depreciation taken each period, the total amount of accumulated depreciation charged, the useful life of each fixed asset, and the remaining value of each fixed asset. Depreciation or use allowance may not be claimed for a fixed asset after the total acquisition cost and the costs of any capitalized additions to the fixed asset have been fully recovered, either through depreciation or use allowance. Inventory records must identify assets purchased with federal funds. The federal government may not be charged for the use of equipment it has purchased. Use allowances and depreciation are discussed in Section 3240, page 85.

2540: Allowable Financing Costs

Financing costs associated with otherwise allowable costs of fixed assets are allowable if these costs (including interest) were paid or incurred after the effective date of the current OMB A-87, and if the following conditions are met.

1. The financing is provided (from other than tax or user fee sources) by a bona fide third party external to the government unit.
2. The assets are in support of federal awards.
3. Earnings on debt service reserve funds or interest earned on borrowed funds pending payment of the construction or acquisition costs are used to offset the current period's cost or the capitalized interest, as appropriate. Earnings subject to being reported to the

federal Internal Revenue Service under arbitrage requirements are excludable.

4. Governmental units will negotiate the amount of allowable interest whenever cash payments (interest, depreciation, use allowances, and contributions) exceed the governmental unit's cash payments and other contributions attributable to that portion of real property used for federal awards.

Section 2600: Electronic Data Processing – Grant Agency Approval

State and federal financial participation in the acquisition of electronic data processing (EDP) equipment, systems, and services specifically to grantee agencies requires prior approval of the federal grantor agency. The California Department of Social Services is the cognizant grantor agency for all of the programs that it administers. Prior approval requirements for the acquisition of EDP equipment, systems, and services purchased from public/private vendors and/or consultants are found in Division 28 of the *Manual of Operations, Policies, and Procedures*, Reference DSS Manual Letter No. 89-01, dated April 1, 1989. It is the responsibility of the county welfare department and the district attorney, family support division, to secure the required approvals through the Health and Human Services Data Center (HHSDC), Project Approval Unit, in accordance with the guidelines set forth in this section and current federal and state regulations.

EDP analysis, design, programming, or implementation efforts directed for use in the administration of public welfare programs also requires prior approval from HHSDC. The costs of these activities, if approved by HHSDC and assigned a project number, must be billed directly to the county welfare department for reimbursement purposes. The costs of all systems development services provided directly to the county welfare system or to the Child Support IV Program must be removed before being carried forward to the Summary/Exhibit of Costs. These costs are not to be included in the OMB A-87 Exhibit of Costs and claimed as overhead. Costs incurred for a system development effort that benefits more than a single department, such as a payroll and activity reporting system, should be identified to the department responsible for providing the system service and distributed to all benefiting departments, funds, and agencies.

Because of the existence of the special requirements of the California Department of Social Services for the reimbursement of grant department systems development costs, it is necessary for each county to identify all systems development work as a separate cost center. The costs of all systems development services provided directly to the county welfare department or Child Support IVD Program must be removed before being carried to the Exhibit of Costs.

Part III: Guidelines for Grant Reimbursement of Space Costs

Section

3100: Purpose and Intent	79
3110: History and Background	79
3120: References	79
Exhibit 3101: Summary of Reimbursement Methods for Capital Expenditures	81
Exhibit 3102: Summary of Reimbursement Methods for Ordinary Expenditures	82
 3200: Characteristics of County-Owned Facilities	 83
3210: County-Owned Space Costs	83
3220: Acquisition Costs.....	83
3230: Facilities Acquired by Transfer, Donation, or Surplus Acquisition	84
3240: Use Allowance or Depreciation.....	85
3250: Interest Expense.....	86
3260: Conversion from Use Allowance to Depreciation.....	88
 3300: Characteristics of County-Leased Facilities	 89
3310: County-Leased Space Costs	89
3320: Reimbursement Methods – Operating Lease Agreements	89
3330: Reimbursement Methods – Capital Leases	90
3335: Sale and Leaseback.....	91
3340: Allowability of Leases.....	91
 3400: Interest	 93

3410:	Rental Rate Components	93
3420:	Rental Rate Charges	93
3430:	Approval Requirements for Rental Rates	94
Exhibit 3401:	Comprehensive Rental Rate Computation	96
3500:	Space Costs Approval.....	98
3510:	Refinancing.....	98
3520:	Grantor Agency Special Agreements	98
3530:	Capitalized Improvement Costs.....	98
3540:	Alteration and Maintenance.....	99
3550:	Documentation Requirements for Claimed Space Costs.....	100
3560:	Comparable Space Costs	100
3570:	Cost Plan Requirements for Claiming Space Costs.....	101
3580:	Inquiry Information	101
3590:	Summary of Space Approval Requirements	103
Exhibit 3501:	Space Terminology	104

Section 3100: Purpose and Intent

Building space is considered a countywide resource regardless of the method used to acquire the space (purchase, construction, lease or rent). Accordingly, the State Controller's Office has been designated as the cognizant grantor agency responsible for the review and approval of all space costs.

The purpose of Part III of this handbook is to summarize the rules and regulations relating to space that have evolved at both the federal and the state level, and to provide guidelines for grant reimbursement of space costs. Exhibits 3101 and 3102, pages 81 and 82, provide a summary of reimbursement methods.

3110: History and Background

Prior to July 1, 1980, the approval to claim costs associated with space occupied by county departments was essentially divided between two grantor agency groups. Costs for space occupied by countywide service departments and non-grantee operating departments could be included in the countywide cost allocation plan for claiming. Approval of the countywide cost plan implicitly included approval of the space costs associated with these departments.

For space occupied by grantee departments and considered to be a direct cost under the grant, a separate and more restrictive set of approval procedures was utilized. Each federal or state grantor agency was responsible for approving the space costs associated with that agency's grant programs. Distinctions were made between county-owned space and rented/leased space. In most cases, rented/leased space required prior approval and had to be claimed as a direct cost, while county-owned space was distributed through the cost plan.

To further complicate matters, special agreements were often negotiated between the grantor agency and a county grantee department to allow for the accelerated claiming of space costs, as opposed to using normal depreciation or use allowance methods. This often resulted in confusion when grantee departments submitted claims for reimbursement of space costs.

Responsibility for space approval was transferred by DHHS to the State Controller effective July 1, 1980. Since that time, information relating to the occupancy of space by county departments has been required each time a countywide cost allocation plan is submitted. However, as with all other costs approved under the principles of OMB A-87, there is one important caveat: acceptance of space costs by the State Controller only establishes that those costs are approved for reimbursement under cost principles. The actual reimbursement of costs claimed is subject to the policies and availability of funds from the individual grantor agencies.

3120: References

Listed below are the references utilized in compiling the information in this part of the handbook. These publications may prove useful to anyone seeking more detailed information regarding the claiming of space costs.

- OMB A-87, Attachment B, Sections 15 and 38, relate to the recovery of space costs.
- DHHS ASMB C-10 addresses cost principles and procedures for developing the cost allocation plan and indirect cost rates for agreement with the federal government (see especially Sections 3-28 through 3-47).
- The State Controller's *Accounting Standards and Procedures for Counties Manual*, Chapter 11, presents the criteria for capital leases; Chapter 15 provides a detailed discussion of fixed assets, including structures and improvements.
- Internal Revenue Service Publication 946, *How to Depreciate Property*, discusses straight-line depreciation and provides property class lives and recovery periods.

Exhibit 3101**Summary of Reimbursement Methods for Capital Expenditures
County-Owned and Non-County-Owned Facilities****Capital Expenditures**

Listed below are types of capital expenditures by category and applicable section of the guidelines.

Acquisitions

Purchase (3220, page 83)
Construction (3220)
Donation (3230, page 84)
Capital Leases (3330, page 90)

Improvements

Capitalized Improvements (3530, page 98)
Additions (3530)

Reimbursement Methods

1. The acquisition and capital improvement costs of county-owned facilities are reimbursable using a 2% use allowance or depreciation. No prior approval is required. (See Sections 3240, page 85, and 3260, page 88).
2. The cost of occupying space under a capital lease, the cost of capital improvements on such facilities, and the costs of associated interest paid or incurred are reimbursable up to amounts that would have been allowed had the county acquired ownership. (See Section 3330, page 90.)
3. The costs of capital improvements on facilities occupied under operating leases are allowable for reimbursement when depreciated over the remaining life of the lease. The resulting lease cost and amortized improvement costs cannot exceed the cost of comparable space in other private sector buildings. (See Section 3530, page 98.)

Exhibit 3102

Summary of Reimbursement Methods for Ordinary Expenditures County-Owned and Non-County-Owned Facilities

Ordinary Expenditures

Listed below are the types of ordinary expenditures and the applicable sections of the guidelines.

Description

Maintenance (3540, page 99)

Alterations and Minor Repairs (3540)

Interest and Other Financing Costs (3250, page 86)

Reimbursement Methods

1. Normal maintenance is treated as an annual operating cost and is allocable for reimbursement in the year of expenditure.
2. Alterations and minor repairs are treated as annual operating costs and are eligible for reimbursement in the year of expenditure to the extent they are not provided for in a rental rate or lease/rental agreement. Social services agencies may claim reimbursement for expenditure amounts approved in their proposed county administrative budget (PCAB) for the year in question. If an alteration project exceeds the approved PCAB amount, the costs should be capitalized for county-owned buildings and amortized over the remaining life of operating leases.
3. Interest paid or incurred and other financing costs associated with building acquisition may qualify for reimbursement under an interest amortization/rental rate.

Section 3200: Characteristics of County-Owned Facilities

Facilities include buildings (offices, storage, jails, museums), special use facilities (auditoriums, convention centers), parking lots, parks, airports, public works facilities (sewage treatment, water treatment), and medical facilities (hospitals, clinics, emergency centers).

County-owned facilities are facilities that are owned by the county, purchased or constructed by the county, or acquired through a capital lease, an exercise of a joint powers agreement, and/or formation of a nonprofit entity.

County-owned facilities may be acquired through many different methods, including purchase, transfer, lease-purchase, donation, construction, surplus property acquisition, and capital lease.

3210: County-Owned Space Costs

The costs of fixed assets may be allocated to the periods benefited using either depreciation or a use allowance. Straight-line depreciation can be used, or a use allowance for buildings and improvements (including land improvements such as paved parking areas, fences, and sidewalks) may be computed at an annual rate that is not greater than 2% of the acquisition costs plus capitalized improvements. A combination of use allowance and depreciation may not be used in connection with a single class of fixed assets. Where a financing agreement is used to acquire a building, the interest expense may be eligible for reimbursement. (See Section 3250, page 86.)

3220: Acquisition Costs

The cost of structures and improvements includes all expenditures incurred in connection with their acquisition, including the following:

1. Purchase price or construction cost;
2. Accident or injury cost during construction;
3. Fixtures attached;
4. Payment of damages resulting from construction;
5. Architects' fees;
6. Insurance expenses during construction;
7. Cost of permits and licenses;
8. Interest expense during construction (see Section 3250); and
9. Landscaping and sidewalk construction incidental to the building's construction and necessary for the use of the building.

The following costs are unallowable under cost principles and must be excluded from acquisition costs:

1. Any cost, or portion of cost, of a facility borne directly or indirectly by the federal (or state) government; and
2. The following costs associated with land: purchase price, condemnation fees, appraisal and negotiation fees, clearing land for use, title search fees, demolishing or removing structures, costs of consents, and filing costs.

Acquisition costs must be reduced by:

1. Amounts received for the sale of salvage from materials charged against the construction;
2. Discounts, allowances, and rebates secured; and
3. Amounts recovered through surrender of liability and casualty insurance.

The interest expense associated with financing a building, once the building is occupied, should not be capitalized as a part of the acquisition costs. Under specified conditions, however, this interest is eligible for reimbursement as an annual expense. (See Section 3410, page 93.)

**3230: Facilities
Acquired by Transfer,
Donation, or Surplus
Acquisition**

When assets are transferred between funds, e.g., between an ISF and the general fund, Chapter 15 of the State Controller's *Accounting Standards and Procedures Manual* dictates that such transactions be regarded as taking place between independent financial entities.

When examining this interfund transfer of facilities from a grant reimbursement perspective, the federal government views the entire county as one distinct governmental entity. The basis for reimbursement of a facility acquired by an operating fund and later sold or transferred to a proprietary fund is the original cost to the county, plus the actual costs of any capital improvements. Reimbursement cannot be arbitrarily increased by recording of the asset at a "fair market value" that, at the time of transfer, is greater than the cost recorded in the records of the fund transferring the property.

The State Controller's *Accounting and Procedures Manual*, Chapter 15, Section 15.10, states that facilities donated to the county from external sources should be recorded at their estimated fair market value on the date they are accepted by the board of supervisors. Purchases of governmental surplus property at nominal prices below market value are in part donations and should be so valued.

In many cases the federal government will have participated in the cost of constructing a facility that is being transferred, donated, or purchased at a bargain price by a county, or reconstructed as a result of a natural disaster. Since the federal government can participate in these costs in many different ways, it is difficult to develop and apply a general set of rules for valuation and each case must be examined on its own merits. To determine an appropriate acquisition cost for grant reimbursement purposes, the State Controller's County Cost Plans Unit should be provided with complete details of the transaction.

3240: Use Allowance or Depreciation

OMB A-87, Attachment B., Section 15, provides that a grantee may be compensated for the use of equipment and other capital expenditures through use allowances or depreciation. A combination of the two methods may *not* be used in connection with a single class of fixed assets. In choosing either method, the following rules must be applied.

1. Regardless of the method used, the computation is based on capitalized costs, as defined in Section 3530, page 98, and supported by actual cost records as defined in Section 3550, page 100. If actual cost records have not been maintained or cannot be reconstructed for a particular facility, a reasonable estimate of the total acquisition costs may be used. All such estimates must be entered into, and reflected on, the county's accounting records for future authenticity. The State Controller's Office must be contacted regarding the procedures for determining estimated acquisition cost.
2. Physical inventories of all fixed assets must be performed at least every two years to ensure that assets on which depreciation or use allowances have been taken exist and are in use. The inventory records and any associated depreciation records must be available for review with all other records that support the cost plan.
3. Records maintained on county buildings must include a listing of the occupant(s) of each building and report the area used by each occupant of any building that has more than a single occupant.
4. When the depreciation method is used, adequate property records must be maintained. These records include depreciation schedules for each facility. The schedules may be part of a formal accounting system or may be supplements to the countywide cost plan.

Straight-line depreciation is the only acceptable method that may be used to allocate the costs of county fixed assets over their useful life unless the county is able to present clear and convincing proof that the expected consumption of an asset will be considerably greater in the earlier portion rather than the later portion of its useful life. Useful life should be based on a useful life study for the facility including such factors as site location, type of construction, and utility to the county given a normal schedule of maintenance but without major renovation.

1. Once implemented, depreciation methods may not be changed unless the change is approved by the State Controller's Office, as the cognizant agency. OMB A-87 states that, when a governmental unit changes from use allowance to depreciation, the depreciation must be computed as if all of the assets in the class had been depreciated since their acquisition.
2. The county must choose either the depreciation method or the use allowance method for a single class of asset (e.g., general-purpose office structures). As defined in Exhibit 3501, Space Terminology, page 104, the single class of assets for buildings in a county is broadly defined as all buildings, including any appurtenant structures or improvements in connection with these buildings.

3. Special use facilities, e.g., waste or water treatment plants or parks, may be considered a separate class of assets for the purposes of implementing this section. Depreciation may be computed on these facilities even though use allowance is utilized on general-purpose office structures.
4. Use allowance or depreciation on fixed assets that are considered excess or idle, or for facilities that are not occupied, may not be charged against grant programs without specific authorization from the grantor agency. Questions regarding this topic should be addressed to the State Controller's County Cost Plans Unit. Include complete details.
5. Whether a county has elected to recover fixed asset costs by depreciation or by use allowance, any claim for reimbursement that will result in cost recovery that exceeds actual cost is unreasonable and unallowable and no further depreciation or use allowance may be claimed. Requests for exceptions to this policy must be fully documented and submitted to the State Controller's County Cost Plans Unit for specific approval. (See ASMB C-10, Part III, Section 3-34.)
6. Revenue received in connection with activities associated with a facility, such as rented space, parking fees, or vendor stands, will be treated under the applicable credit rule of OMB A-87, Attachment A, Section C.4 (see handbook Section 2210, Allowable Income (Revenue), page 51).

All space costs claimed through use allowance or depreciation *must* be claimed through the countywide cost allocation plan.

3250: Interest Expense

Under OMB A-87, Attachment B. 26, financing costs (including interest) incurred or paid on or after September 1, 1995, associated with the otherwise allowable costs of building acquisition, construction, fabrication, reconstruction, or remodeling completed on or after October 1980 are allowable. This section also allows financing costs (including interest) incurred or paid after September 1, 1995, associated with otherwise allowable costs of equipment. The actual interest expense either paid or accrued by a county may be claimed for reimbursement through the use of an interest amortization/rental rate system based on actual costs. Interest amortization is discussed in Section 3400, page 93.

The condition placed upon the allowability of interest costs for a publicly owned building is that it must be newly occupied on or after October 1, 1980. Following are examples.

1. Non-grantee departments, prior to October 1, 1980, occupy a county-owned building. Subsequent to that date, the building is vacated and reoccupied by grantee departments. Interest costs are not eligible as a rental rate component since the building was occupied prior to October 1, 1980.

2. A county-owned building is acquired prior to October 1, 1980, but remains unoccupied until after that date. Interest costs are an allowable component in the rental rate since the building was newly occupied on or after October 1, 1980.
3. A rented (non-county) building is occupied by a grantee department prior to October 1, 1980. Subsequent to that date the county purchases the building, making it county-owned. Even though the building was occupied prior to October 1, 1980, it did not meet the test of publicly owned, since it was rented. Therefore, interest costs are an allowable component of the rental rate since the building became a publicly owned facility, and newly occupied as such, after October 1, 1980.

Reimbursement may be claimed for interest costs incurred on a building acquired under a lease required to be treated as a capital lease under governmental generally accepted accounting principles, a sale and leaseback arrangement, or a less-than-arms-length lease agreement in accordance with OMB A-87, Attachment B. Section 38.

1. In the case of capital leases, the lease is treated as an installment purchase of the property. Since installment purchases invariably require the payment of interest, an imputed interest expense would be allowable under this type of lease. The amount of interest expense should be determined from the information in the lease agreement and/or information obtained from the lessor. If this is not possible, the interest expense should be based on the interest rate charged to the county in similar borrowing arrangements (at the time of the lease execution.)
2. Rental costs under sale and leaseback arrangements are allowable only up to the amount that would be allowed had the governmental unit continued to own the property.
3. Under a less-than-arms-length lease, the property is treated as though the lessee instead of the lessor had purchased it. If a lessor incurs an interest expense in purchasing the property, this expense would be considered as an expense of the lessee and would be allowable.

If a building qualifies under OMB A-87, Attachment B. Section 38, the interest expense incurred during the construction of the building (or other period needed to get the building ready for use) is an allowable component of the total capitalized cost of the building. This interest expense, along with other capitalized costs of the building, should be claimed as a component of a use allowance if the building was newly occupied on or after October 1, 1980.

Interest costs incurred or paid for the acquisition of land acquired in connection with the acquisition of a building after June 30, 1996, are allowable. Interest on the acquisition of land by itself is not allowable. Principal payments for the acquisition of land are unallowable.

When part of the financing costs of a building is charged to the federal government, either directly or through the cost plan, the federal government must also participate in any income earned by the county that is related to that financing. If a county finances a building by issuing bonds and sets up a sinking fund to retire the bonds, the income earned by the sinking fund must be offset against the interest expense. Interest amortization and rental rate computations are discussed in Section 3400, page 93.

**3260: Conversion from
Use Allowance
to Depreciation**

A county may wish to convert from the use allowance to the depreciation method. Before such a conversion is made, complete details must be submitted to the State Controller's Office, County Cost Plan Unit, for review. Failure to do so may result in subsequent disapproval of depreciation costs included in the countywide cost plan(s).

There are two important points to consider when changing from a use allowance to a depreciation system. First, the combination of use allowance and depreciation cannot exceed the acquisition cost of the fixed assets. Second, as of the date of conversion, any asset whose useful life has exceeded its original depreciable life, as measured from the date of acquisition, will be considered fully depreciated. No further depreciation will be allowed and a use allowance will be allowed in only extremely rare circumstances. (See Section 3240, page 86, item 5, of this handbook and ASMB C-10, Sections 3-30 and 3-34.)

Section 3300: Characteristics of County-Leased Facilities

A lease agreement conveys property rights for a specific period of time. County-leased facilities include facilities obtained on a month-to-month basis and those obtained by an operating lease. Although actual title to a facility is not transferred by a lease arrangement, each lease agreement should be evaluated to determine if the agreement should be treated as an in-substance purchase. Cost plan coordinators should be especially aware that renewal of a lease may result in a total lease term that is equal to 75% or more of the estimated economic life of the leased property, a situation that would require that the lease be capitalized. See Section 3330, page 90, for the conditions that require that a lease be classified as a capital lease.

3310: County-Leased

Space Costs OMB A-87, Attachment B, Section 38, states that rental costs are allowable to the extent that the rates are reasonable in light of such factors as: rental costs of comparable property, if any; market conditions in the area; alternatives available; and the type, life expectancy, condition, and value of the property leased. There are many different types of leasing arrangements, including the following:

1. Monthly rental
2. Annual rental/lease
3. Lease with option to purchase
4. Capital leases/lease purchases
5. Sale-and-leaseback arrangements
6. Less-than-arms-length lease

3320: Reimbursement Methods - Operating Lease Agreements

Monthly rentals and annual rentals/leases meet the criteria for operating leases under the State Controller's *Accounting Standards and Procedures Manual*, Chapter 11, Section 11.17. Under an ordinary rental/lease contract, one party (the lessor) conveys property to another (the county) for a specified rent. The county acquires no interest in the property beyond the right of usage during the term of the lease or rental agreement. Neither an asset nor an obligation is recorded for operating leases. Rental payments are recognized as expenditures. Only lease payments made for operating leases may be claimed for grant reimbursement purposes.

Reimbursement for the costs of space occupied under straight lease or rental agreements is allowable to the extent that costs are reasonable in relation to the rental costs of comparable space in privately owned buildings in the same locality. Month-to-month rental arrangements should be limited to emergency or other short-term occupancy situations, since they can be more expensive than annual rental agreements.

Prior approval is not required to claim reimbursement for operating lease costs, but the costs must be within comparable rental rates. See Section 3310 for requirements regarding comparable rental rate information.

3330: Reimbursement Methods - Capital Leases

Operating lease costs may be claimed as direct costs when paid from the grantee budget unit. If paid from a central appropriation, they must be included in the countywide cost allocation plan.

Lease-purchases, certain leases with option to purchase, and material equity leases are, according to the State Controller's *Accounting Standards and Procedures Manual*, deemed to represent substantially all of the benefits and risks incident to ownership of the property and are considered capital leases. A capital lease is, for the most part, viewed as an installment purchase of property rather than the rental of property and should be accounted for as the acquisition of an asset and the incurrence of an obligation by the lessee.

National Council on Governmental Accounting Standards Number 5 requires that governments follow the capital lease accounting and reporting standards established by Financial Accounting Standards Board Statement 13 (FASB-13). FASB-13 requires that a lease be capitalized if any one of the following four criteria are characteristic of the lease transaction during the fixed, non-cancelable term of the lease.

1. The lease transfers ownership of the property to the lessee by the end of the lease term.
2. The lease contains a bargain purchase option.
3. The lease term, including bargain renewal options at inception, is substantially (75% or more) equal to the estimated economic life of the leased property, including earlier years of use. This criterion is not applicable when the beginning of the lease term falls within the last 25% of the total estimated economic life of the leased property.
4. The present value of the minimum lease payments at the beginning of the lease term, excluding executory costs and profits thereon to be paid by the lessor, is 90% or more of the fair value of the property at the inception of the lease. This criterion cannot be used for a lease that begins within the last 25% of the original estimated economic life of the leased property.

FASB-98 defines a lease term as the fixed non-cancelable term of the lease plus any of the following periods:

1. A period for which failure to renew the lease imposes a penalty on the lessee in an amount such that, at the inception of the lease, renewal appears to be reasonably assured.
2. A period covered by a bargain purchase option, i.e., the lessee's option to purchase the leased property at a sufficiently low price that makes the exercise of the option relatively certain.
3. A period in which penalties are imposed in an amount that, at the inception of the lease, reasonably assures the renewal of the lease by the lessee.
4. A period covered by ordinary renewal options, during which a guarantee by the lessee of the lessor's debt that is directly or indirectly related to the leased property is expected to be in effect or

a loan from the lessee to the lessor that is directly or indirectly related to the leased property is expected to be outstanding.

5. A period covered by ordinary renewal options preceding the date on which a bargain purchase is exercisable.
6. A period that represents renewals or extensions of the lease at the lessor's option. However, the lease term cannot extend beyond the date of a bargain purchase option.

Under a less-than-arms-length lease, one party to the lease agreement is able to control or substantially influence the operating and financial policies of the other party. Such leases include, but are not limited to, those between (1) divisions of an organization, (2) organizations under common control through common officers, directors, members, and (3) an organization and a director, trustee, officer, or key employee of the organization or his/her family, either directly or through corporations, trusts or similar arrangements in which they hold a controlling interest.

A government related-party transaction may arise between a state or local government and a public authority. A public authority is created to raise funds through the issuance of debt, the proceeds of which will be used to purchase or construct fixed assets. These assets may be leased by the public authority to the state or local governmental unit, with title passing to the governmental unit at the end of the lease term.

The accounting treatment of a lease between a state or local government and a public authority is dependent on whether the public authority is part of the overall governmental reporting entity or subject to its managerial or financial control.

3335: Sale and Leaseback

Under a sale-and-leaseback arrangement, property owned by an organization is sold to and leased from another organization or individual. The property sold and any related liabilities are eliminated from the seller-lessee's accounting records and a gain or loss on the sale portion of the sale-leaseback is recognized by the seller-lessee.

3340: Allowability of Leases

Reimbursement for capital leases is available as follows.

1. Rental (lease) costs for capital leases are allowable only up to the amount that would be allowed under applicable cost principals had the county purchased the property on the date the lease agreement was executed (e.g., depreciation or use allowances, maintenance, taxes, insurance, etc., but excluding unallowable costs).
2. Rental (lease) costs under lease-with-option-to-purchase agreements that meet the criteria of a capital lease are allowable as specified in the paragraph above. Otherwise, they are reimbursable as operating leases, provided approval is received from the State Controller's Office to do so.
3. Rental (lease) costs under sale-and-leaseback arrangements are allowable only up to the amount that would be allowed under

applicable cost principles had the county continued to own the property.

4. Rental (lease) costs under less-than-arms-length leases are allowable only up to the amount that would be allowed under applicable cost principles had title to the property vested in the county.

Interest or other financing costs are unallowable in determining the acquisition cost of a facility, except as provided for in Section 3250. However, they are allowable for reimbursement purposes when included in rental rates computed under specified conditions. See Section 3410 for a discussion of rental rates and Section 3420, page 93, for a discussion of interest expense. The costs of facilities under capital leases are to be claimed through the countywide cost allocation plan.

Section 3400: Interest

Interest expenses incurred or paid after building occupancy for the acquisition or construction of a building may be expensed over the life of the financing instrument. Allowable interest may be expensed as it is paid or amortized, or it may be expensed on a straight-line basis. The method by which such amortization has been effected has been referred to as a “rental rate system.” Interest amortization may be accomplished by any acceptable system that results in charges based upon actual costs regardless of whether the costs are treated as direct or indirect costs and regardless of whether the costs are billed to user departments or are allocated through a cost allocation plan. Any costs included in an interest amortization/rental rate schedule may not be charged or allocated elsewhere. Exhibit 3401, page 96, provides a comprehensive example of a rental rate system computation.

3410: Rental Rate Components

Interest expenses incurred or paid after building occupancy for the acquisition or construction of a building may be amortized over the life of the financing instrument. Interest expense must be computed on amounts actually paid or incurred for building purchase or construction. The method by which such amortization is effected is referred to as a rental rate system. A rental rate system is defined as any acceptable costing system that results in charges based on actual costs, regardless of whether the costs are treated as direct or indirect costs and regardless of whether the costs are billed to used departments or are allocated through a cost allocation plan. Any costs included in a "rental rate" computation may not be charged or allocated elsewhere.

3420: Rental Rate Charges

The following elements can be included in rental rate charges when they are based on costs that were actually incurred or paid.

Either use allowance or depreciation expense (depending upon the treatment of other county buildings) may be included in rate computations for building cost. The acquisition costs or construction costs must be fully supported.

1. If a county-owned facility was occupied on or after October 1, 1980, the annual interest charges for financing the building's construction or purchase may be included in the rate computation. The actual interest paid or incurred by the county on a purchase contract or capitalized construction costs less any interest credits, where applicable, may be included in the rental rate charges.
2. Interest paid for the acquisition of land when the land was acquired in connection with the acquisition of a building after July 1, 1996, is allowable per ASMB C-10, Section 3-43.
3. Interest payable over the life of the financing agreement must be supported by an interest amortization schedule.
4. The issuance cost of a bond, which consists of professional fees, selling commissions, printing costs, etc., should be identified on the statement that presents the details of the proceeds of issuance. Issue costs may be amortized over the term of the financing agreement on

a straight-line basis and included as a component of rental rate computations.

5. Any premium or discount on the financing instrument is identified on the statement that shows the breakdown of proceeds of the issuance. A premium or discount may be amortized over the term of the financing agreement on a straight-line basis and included as a component of the rental rate computation.
6. Bond reserves can be included in a financing instrument for unforeseen or underestimated costs. These reserves are identified on the statement that presents the details of issuance proceeds. Only that portion of the contingency that is actually expended toward the facility may be amortized over the term of the financing agreement on a straight-line basis and included as a component of the rental rate computations.

Recurring costs of servicing a building, such as maintenance fees/expenses, related administrative costs, taxes, and insurance, are allowable and may be charged directly to benefiting departments or allocated to these departments through the cost plan. If not included in the rental rate, these costs can be included in the countywide cost plan for further allocation to the occupying departments.

The bond reserve portion of the proceeds from a bond sale is retained by the institution that is designated as trustee for the lender. This fund is to be used for payment of principle and interest should the county be unable to make a payment. Any unused portion of the reserve fund will be used to make the final payments on the debt. In either case, the bond reserve is used to make principal and interest payments and represents a source of loan repayment. The reserve fund and its prorated share of interest expense are not eligible for inclusion in the rental computation for reimbursement purpose.

3430: Approval Requirements for Rental Rates

Costs claimed on the basis of rental rate systems that include interest and financing charges no longer require prior approval from the State Controller. However, all counties must maintain complete, comprehensive cost information on file supporting rental rates for buildings used by central support and grant departments. All rental rates claimed in countywide cost plans must be fully described in the narrative that prefaces the space or building use section of the cost plan.

Rental rates and the associated costs of new buildings occupied by central support and grant departments are examined during State Controller field reviews. These examinations include verification that all capitalized expenditures are fully supported and accurately reflect the costs of procuring or purchasing buildings and preparing them for occupancy, that these costs have been correctly capitalized, that recovery of these capitalized costs is in accordance with OMB A-87, and that all cost amortization schedules are correct.

Counties may expense or amortize interest, as they prefer, for the acquisition of buildings and related land, construction or fabrication, reconstruction, or

remodeling subject to the criteria, enunciated in OMB A-87, Attachment B, Section 26, and ASMB C-10, Section 3-43.

Once a rental rate schedule has been used to assign building costs in a countywide cost allocation plan, the same schedule must be consistently used for the life of the associated building unless, the State Controller's Office determines that the rental charges should be modified or abolished. Costs based on estimated rental rates may be billed to the occupants of the associated buildings but these estimated charges must be adjusted to actual costs, based upon finalized rental rates presented in the countywide cost plan. A rental rate may be increased by 2% for the value of documented capital improvements to a building.

Exhibit 3401**Comprehensive Rental Rate Computation**

The following chart is an example of a comprehensive rental rate computation for a county welfare department. In this example, the county purchased a 20,000-square-foot building for use as the department's main office. The building was financed by the issuance of 20-year bonds. This example demonstrates how the costs of the building, bond issue components, and interest expense are included as rental rate charges. The cost of land is unallowable under the cost principles; however, interest paid on the acquisition of land is allowable. The bond reserve component is not a cost to the county and, therefore, it is not included in the rental rate. Interest expense related to the bond reserve is also excluded. All costs shown represent actual cost.

Acquisition Cost:

Building and Architect Expenses	\$1,113,854	91.01%	Allowable
Land	110,000	8.99%	Unallowable
Total Acquisition Costs	<u>\$1,223,854</u>	<u>100.00%</u>	

Use Allowances:

Building Costs and Architect Expenses	\$1,113,854
	<u>x 2%</u>
Building Use Allowance	\$22,277

Computation of Annual Allowable Costs and Percentage Factors (Example)**Proceeds of Bond Issue:**

	<u>Total</u>	<u>Allowable</u>	<u>Unallowable</u>
Building Cost	\$1,095,319	\$1,095,319	
Architect Expenses	18,535	18,535	
Building Costs/Architect Expenses	<u>1,113,854</u>	<u>1,113,854</u>	
Bond Discount	45,771	41,656	4,115
Bond Issue Costs:			
Attorney Fees	26,118		
Bond Printing Fees	3,592		
Financial Consulting	36,382		
Bank Trustee Fees	<u>6,919</u>		
Total Bond Costs	73,011	66,447	6,564
Land Cost	110,000		110,000
Bond Reserve Fund	172,390		172,390
Other	19,974		19,974
Total Bond Issue Costs	<u>\$1,535,000</u>	<u>\$1,221,957</u>	<u>\$313,043</u>

The discount and issue costs are distributed to the “Allowable” and the “Unallowable” columns using the percentages that building costs and land costs constitute of total building and land costs (91.01% and 8.99%). The allowable portions of the discount costs and issue costs will be recovered on a straight-line basis over the 20-year term of the bonds; $(41,656 + 66,447) \div 20 = 5,405$ per year.

Year	Annual Interest ¹	2% Use Allowance	Amortized Discount and Issue Costs	Claimable Costs ²	Monthly Claimable Costs	\$ Cost per Sq. Foot ³
1	135,485	22,277	5,406	163,168	13,597	8.16
2	133,295	22,277	5,406	160,978	13,415	8.05
3	130,740	22,277	5,406	158,423	13,202	7.92
4	128,185	22,277	5,405	155,867	12,989	7.79
5	125,265	22,277	5,405	152,947	12,746	7.65
6	121,890	22,277	5,405	149,572	12,464	7.48
7	118,403	22,277	5,405	146,085	12,174	7.30
8	114,403	22,277	5,405	142,085	11,480	7.10
9	109,865	22,277	5,405	137,547	11,462	6.88
10	104,765	22,277	5,405	132,447	11,037	6.62
11	99,110	22,277	5,405	126,792	10,566	6.34
12	92,880	22,277	5,405	120,562	10,047	6.03
13	86,130	22,277	5,405	113,812	9,484	5.69
14	78,395	22,277	5,405	106,077	8,840	5.30
15	70,115	22,277	5,405	97,797	8,150	4.89
16	60,915	22,277	5,405	88,597	7,383	4.43
17	50,685	22,277	5,405	78,367	6,531	3.92
18	39,525	22,277	5,405	67,207	5,601	3.36
19	27,435	22,277	5,405	55,117	4,593	2.76
20	14,415	22,277	5,405	42,097	3,508	2.10
Total	1,841,900		108,103	2,395,542		
21 >	0	22,277	0	22,277	1,856	1.11

¹ This example assumes a debt that is incurred at the beginning of the first fiscal year. In cases where debt is incurred at some other point of the fiscal year, interest and amortized costs would have to be prorated for the first and final year of the debt financing.

Building interest is allowable for county-owned facilities occupied on or after October 1, 1980.

Interest paid after July 1, 1996, for the acquisition of land is allowable per ASMB C-10, Section 3-43.

Allowable interest costs may be computed as incurred or straight-line $(1,841,901 \div 20 = 92,095)$.

² Total costs that may be claimed for the year are the sum of the allowable interest costs, the amortized allowable bond discount and issue costs, and a two-percent use allowance on the total cost of the building.

³ In this example, the total useable square feet occupied by all of the residents of the building is assumed to be 20,000 square feet. The costs per square foot may be used to distribute total yearly building costs to each occupant of the building.

Section 3500: Space Costs Approval

Approval of the countywide cost plan incorporates approval for grant reimbursement purposes of all space costs that are included in the cost plan.

The following sections of this handbook address areas of space costs reimbursement methods.

3510: Refinancing

If a county elects to refinance the debt used to finance construction of county buildings, it can be reimbursed only up to the original amount approved.

For example, a Rental Rate Schedule that is amortized over 20 years has been approved for \$12 million (this includes interest expense, issuance costs, and the 2% use allowance). The county has been reimbursed a total of \$3 million during the past 3 years. If the county refinances, it can be reimbursed at the new rate as long as the future reimbursements (including interest expense, issuance costs, and the 2% use allowance) do not exceed \$9 million.

If, due to the refinancing, future reimbursements exceed \$9 million (the remaining amount approved in the original rental rate), the county would be responsible for the additional costs.

If future reimbursements are less than \$9 million, the savings must be proportionally shared with all participating grant programs. For example, if the refinancing requires \$8 million in reimbursable costs, only this \$8 million will be reimbursed.

3520: Grantor Agency Special Agreements

If a county has received past approval from a grantor agency to claim space costs under a negotiated special agreement, the county must continue to claim in accordance with that agreement until it expires, or until the conditions set forth in the agreement change. At this time, the State Controller's Office should be contacted for further instructions.

3530: Capitalized Improvement Costs

Chapter 15, Section 15.07, of the State Controller's *Accounting Standards and Procedures Manual* defines capital expenditures incurred on fixed assets after their original acquisition.

1. Capitalized expenditures are defined as expenditures that materially add to the value or the utility of property or appreciably extend its life. The cost of capitalized expenditures should be added to the book value of the asset where the original cost of a component being improved can be specifically identified. This original amount should be written off and the new cost capitalized. Capitalized expenditures are on occasion referred to as betterments.

The decision as to whether an expenditure should be capitalized shall be made by an evaluation of engineering, physical, or other relevant factors apart from cost.

2. Additions are new and separate units or extensions of existing units and are considered to be capital assets. As with betterments, the test

of significance should be applied. Additions and improvements to infrastructure assets should be capitalized.

Costs associated with capitalized improvements for county-owned facilities, or with facilities acquired under a capital lease, are allowable for reimbursement when capitalized and claimed through normal use allowance in the countywide cost allocation plan. No prior approval is required for reimbursement. Since most counties in California utilize the use allowance method for claiming reimbursement for space costs, the cost of a capital improvement would be claimed using the 2% use allowance allowed by OMB A-87, Attachment B, Section 15. Counties that routinely compute annual depreciation for all county-owned buildings must depreciate the cost of any capital improvements over the remaining useful life of the building. If a capital improvement appreciably extends the useful life of the building, the extended period should be used.

The costs associated with capital improvements on facilities occupied under an operating lease should be depreciated over the remaining period of the lease. The resulting monthly lease cost plus amortized improvement costs must not exceed the rental costs of comparable space in a privately owned facility. The county must obtain new documentation on comparable rental rates, as described in Section 3560, page 100, to ensure that the total costs claimed for the improved leased building do not exceed the costs of space in privately owned buildings.

No prior approval is required for reimbursement, but new capital improvements should be disclosed and described in the narrative for the space schedule. Future field reviews and/or audits will determine whether improvements were both necessary and reasonable.

Capital improvement costs on operating leases may be claimed as direct costs only if paid directly from a grant recipient's budget or billed to the grantee. Otherwise, they must be claimed through the countywide cost allocation plan. If billed, they must be adjusted to actual in the plan.

When making capital improvements to a facility occupied under an operating lease, the county must ensure that the improvement is both necessary and reasonable for the proper and efficient administration of the grant program because of the limited period available for the use and benefit of the improvement.

3540: Alteration and Maintenance

Chapter 15, Section 15.07, of the State Controller's *Accounting Standards and Procedures Manual* defines alterations and maintenance as follows.

1. Maintenance is defined as expenditures that neither materially add to the value of property nor appreciably prolong its life, but merely keep it in an ordinary efficient operating condition. Maintenance costs shall not be capitalized.
2. Alterations are changes in the physical structure or arrangement of fixed assets that do not qualify as an increase in fixed asset value

under the preceding definitions of betterments and additions. Alterations shall not be capitalized.

Normal maintenance costs on county-owned or rented facilities are allowable for reimbursement in the year of expenditure to the extent that they are not otherwise included in rent or other charges for space. Maintenance costs may be claimed through the countywide cost plan, or as direct costs if billed to or paid directly from the grantee's budget. No prior approval is required for reimbursement of maintenance costs.

Alteration costs on county-owned or rented facilities that will benefit the operation of a grant program must be coordinated with the cognizant agency for that grant. Alteration and maintenance costs that are not classified as capital improvements may be claimed through the countywide cost allocation plan. Expenditures that are directly chargeable to federal awards may be billed to or paid directly from the grantee's budget unit.

If an alteration or a maintenance project substantially increases the capacity, value, operating efficiency, or useful life of an asset, the associated costs must be capitalized and recovered through depreciation or use allowance, depending upon the treatment that has been afforded other fixed assets of the same class.

3550: Documentation Requirements for Claimed Space Costs

Complete documentation on the costs of space claimed against federal or state grants is required to be maintained on file in the county, regardless of the method of claiming. This documentation may take the form of contracts, lease agreements, board resolutions, and any other information necessary to describe the facility and the conditions of occupancy. This supporting material must be retained as long as the facility is occupied by county departments and for a period of three full years after the facility has been vacated.

3560: Comparable Space Costs

Although all space costs claimed must be within comparable rental amounts, space occupied under operating lease or rental agreements or rental rate systems is subject to an additional requirement. For each facility leased, rented, or claimed under a rental rate, three comparable rents must be obtained and the rate for the facility under consideration must be within the range of these rates, taking into consideration such factors as market conditions in the area, alternatives available, and the type, life expectancy, condition, and value of the property. This condition also applies to the renewal of existing operating leases or increased costs due to leasehold improvements.

A comparable rental rate is the rate that would be charged for a non-county owned building or parking lot that would suit the intended purposes if occupied by the county. The comparable building should be in a location suitable to the grantee program and be similar in size (square footage), construction, and cost per square foot (including maintenance, utilities, and any applicable taxes). The existence of a single rent that is significantly higher than others in the same locality would not have a bearing on the

claiming, since it should be treated as an aberration and excluded from the comparable rent study.

Comparable rental rates are required for cost comparison purposes only and the facilities do not need to be vacant. The comparison is to be retained in county files for those buildings rented/leased after January 1, 1979, and is to adhere to the following rules.

1. Counties must obtain three comparable rates for privately owned space in the same general locality. The following information must be obtained for each comparable address: monthly rent amount; cost per square foot and/or per parking space; whether services are included in the rate; and the number of parking spaces available.
2. If the county states that there are no comparable facilities, it should obtain an estimate of rental rates by a certified real estate appraiser.
3. The cost per square foot of a building, including maintenance, utilities, alterations, taxes, etc., may not materially exceed the cost of the highest comparable in order for the cost to be appropriate for state/federal financial participation.

3570: Cost Plan Requirements for Claiming Space Costs

In order for cost plan approvals to be processed on a timely basis, the following information must be submitted annually, either as part of the cost plan or as a supplement submitted with the cost plan:

1. A narrative of the methods and procedures used to determine and distribute all space costs being claimed for reimbursement, whether direct billed, allocated, or claimed as a direct expense or negotiated cost.
2. A cost summary schedule for all space costs associated with county-owned buildings or capital leases allocated through the cost plan, using depreciation, use allowance, or a negotiated special agreement.
3. A cost summary schedule for all space costs associated with rented space, where the rents are paid by a central budget unit and then billed or allocated to the occupying departments. The allocations of allowable rent must be offset by all rent billed to the occupants. Allowable rent excludes rental payments on a capital lease facility.

Detail schedules supporting the summary schedules required by items 2 and 3 above must be on file and available for review in the county.

When rent is paid directly from a grant recipient's budget unit and claimed as a direct cost, supplemental information listing any special claiming agreements negotiated with grantor agencies, including expiration dates and descriptions of the method used for claiming (cost plan allocation or direct cost) must be available for review.

3580: Inquiry Information

If the need arises to submit information concerning the acquisition or alteration of a building, the following topics should be addressed.

Current Facility

Background:

1. Address, size, and type of construction.
2. Date, cost, and method of acquisition by county.
 - a. Procedures used to claim reimbursement for the acquisition costs.
 - b. Grant recipient's date of occupancy and share of space occupied.
 - c. Identification of other departments also occupying space in this facility.
 - d. Estimate of the remaining useful life of the facility, given a normal maintenance and repair schedule.

Date, cost, and types of past improvements to the facility:

1. Method of payment for and procedures to claim reimbursement of the costs of improvements.
2. Grantee's share of improvement costs.
3. Estimate of the remaining useful life of the improvements.

Supporting information:

1. Copies of the lease agreement where the facility is leased, rented, or acquired under a lease-purchase agreement.
2. Copies of any special claiming agreements issued by the California Department of Social Services (previously Benefit Payments) for reimbursement purposes.

Project Proposal: Alteration of Existing Facility or Acquisition of New Facility

1. Description of the project, including start and completion dates and an estimate of total cost.
2. Identification and description of project costs in the following areas:
 - a. Minor renovations and alterations of existing space, where applicable;
 - b. Major renovation of existing space and additions of new space, where applicable;
 - c. Modifications and additions to existing utilities required as a result of the addition;
 - d. Parking lot and landscaping costs associated with the project; and
 - e. Acquisition/construction costs or lease costs of a new facility.
3. Copies of any schematic drawings that will be useful in understanding the scope of the project.
4. An estimate of the useful life of the improvements on the new facility.

5. When the proposal entails altering an existing facility, an estimate of how many more years the grantee departments will be able to use this facility after completion of the proposed project.
6. The proposed method of funding the cost of the project, independent of the reimbursement available from the State.
7. Copies of three current comparable rental rates for private space in the same general area.

3590: Summary of Space Approval Requirements

Approval of the countywide cost plan by the State Controller's Office incorporates approval for grant reimbursement purposes of all space costs that are included in the cost plan. Prior approval for the acquisition of a new facility through purchase, construction or a capital lease that is to be claimed through use allowance or depreciation is not required. Notification to the State Controller of a pending acquisition will help to avoid a delay in cost plan approval or revision to a prepared cost plan.

Prior approval by the State Controller's Office is not required to claim reimbursement for the costs of an operating lease. However, the costs must be within comparable rental rates.

1. Approval from the reimbursing grantor agency is required prior to claiming when computing use allowance or depreciation on idle or excess facilities for a period of non-occupancy by a grantee department, or facilities considered fully depreciated.
2. Approval prior to claiming is required from the State Controller's Office when the county intends to claim the lease payments of a lease-purchase or a lease-with-option-to-purchase/renew agreement that the county interprets as an operating lease.

Any questions regarding space approval or related subjects, should be addressed to:

Cost Plan and Local Apportionments Section
Division of Accounting and Reporting
State Controller's Office
P.O. Box 942850
Sacramento, CA 94250

Exhibit 3501

Space Terminology

The following terms are used in the State Controller's interpretation of OMB A-87.

Abatement	A refund of the unearned portion of federal or state participation or equity in the cost of a building on which claiming has been accelerated faster than normally allowed under use allowance or depreciation. The amount of abatement can be the amount of participation less the earned use allowance or depreciation, whichever is applicable. Or, the abatement can represent a return in equity in the facility.
Acquisition Cost	The actual cost of the building, exclusive of the cost or any portion of the cost of the building donated or borne directly or indirectly by the federal government or through charges to federal grant programs or otherwise, irrespective of where title was originally vested or where it presently resides. In addition, acquisition cost excludes the cost of land and interest. Where actual cost records have not been maintained, a reasonable estimate of the original acquisition cost may be used in the computation.
Additions	Additions are new and separate units or extensions of existing units to increase square footage. The entire cost of an addition is treated as a fixed asset where a significant betterment or capitalized expenditure has occurred.
Alteration	Changes in the physical structure or arrangement of a facility (fixed asset), the cost of which does not qualify as an increase in fixed asset value under the definitions of betterments and additions. Alteration costs may not be capitalized.
Betterment	Replacement of a unit of an existing structure by an improved or superior unit, resulting in a more productive, efficient, or longer-lived property. Significant betterments are added to the value of the property improved.
Cognizant Agency	The agency having the responsibility and authority to review, negotiate, and approve the procedures and costs for grant reimbursement. The State Controller's Office has been designated by DHHS as cognizant agency for space costs reimbursement.
Depreciation	Depreciation is used to allocate the costs of fixed assets throughout their useful life. The basis of accounting for depreciable fixed assets is capitalized costs, including all of the normal expenditures required to prepare these assets for use. All fixed asset costs must be fully supported by property records. The useful life of any fixed asset will be that established for the applicable class of fixed assets in the Internal Revenue Service guidelines for straight line depreciation. OMB A-87 states, "In the absence of clear evidence indicating that the expected consumption of the asset will be greater in the early portions than in the later portions of its useful life, the straight line method of depreciation will be used." ASMB C-10 adds, "The straight line procedure is presumed to be the only acceptable method because it is

extremely difficult to demonstrate that the expected consumption of an asset will be significantly greater in earlier portions of its useful life.”

Donated Facilities	Facilities donated to the county. They should be recorded at their fair market value as of the date of the gift. Facilities designated as surplus property of another governmental entity and purchased by the county at nominal prices far below the facility's fair market value are in part donations and should be valued as such.
Fixed Assets	Tangible assets of significant value having a utility that extends beyond the year of acquisition.
Fixtures	Permanent attachments to structures. Fixtures are not intended to be removed; they function as part of the structure.
Fully Depreciated Facility	Any facility whose useful life has exceeded its depreciable life, as measured from the date of acquisition (or alteration). Full depreciation applies to facilities whose total actual costs has been recovered through the application of depreciation expense or a use allowance.
Grant Agency	The ultimate user of grant funds. Examples include the county in general or a specific county department, such as welfare.
Grantor Agency	The state or federal agencies that are the ultimate source of grant funds. DHHS is an example.
Idle Facility	An unoccupied or unused building, or a portion of unoccupied or unused space within a building.
Land (Cost of)	The investment, held in fee title, in real estate other than structures and improvements and land acquired for street, road, and flood control purposes.
Maintenance	Expenditures that neither materially add to the value of a facility nor appreciably prolong its life, but merely keep it in an ordinary, efficient operating condition. Maintenance costs are not capitalized.
Modulars	Normally, buildings manufactured at one location and then transported either assembled or unassembled to the location where they will be utilized. They are then placed on some form of foundation and connected to water, sewer, and power lines. If previously specifically approved by the State Controller's Office, modulars may be treated as a separate class of fixed assets and depreciated on a straight line basis over a period of 12 years or more.
Reconstruction	Major or extraordinary renovation resulting in a significant betterment to a facility.
Renovation	Major or extraordinary construction or reconstruction of a facility, the entire cost of which is treated as a significant betterment and added to the cost of the facility (capitalized).

Rental Rate System	Any acceptable costing system that results in charges based on actual costs, regardless of whether the costs are treated as direct or indirect costs and regardless of whether the costs are billed to users or allocated through a cost allocation plan. Rental rate charges may include building depreciation or use allowance, interest (qualified), bond issuance expenses, utilities, janitorial services, security, parking, etc.
Single Class of Assets	<p>Broadly defined, all buildings, including any appurtenant structures or improvements in connection with the buildings. Because of the basic assumptions underlying the use of the depreciation or use allowance methods for recovering building costs, a prohibition is placed on the use of a combination of these two methods in a single class of assets for grant reimbursement purposes.</p> <p>Any special use facilities such as waste treatment plants, water treatment plants, parks, etc., may be considered as separate classes of assets, with depreciation or use allowance computed without regard to the method chosen for the general class of office buildings.</p>
Structures and Improvements (Facilities)	Physical properties of a permanent nature: for example, buildings, structural attachments, storage tanks, reservoirs, and parking areas. Sidewalks, trees, and driveways in connection with the structures are recognized to the extent that they are necessary for the use of the facility.
Use Allowance	A use allowance may be used in lieu of depreciation to claim reimbursement for facilities or equipment. The use allowance is computed annually at no more than 2% of the building's acquisition cost and 6 2/3% for equipment acquisition cost. The use allowance method is based on an averaging concept that implicitly recognizes that certain assets within each broad category have longer lives than average, while others have shorter lives.
Useful Life	That period of life from the date a facility is purchased, constructed, or altered to the date the facility is no longer efficiently useable without renovation (the latter can be determined by independent appraisal). The period of useful service or useful life established for each facility must include such factors as type of construction, nature of facility use, site location, etc.

Part IV: Guidelines for Grant Reimbursement of Self-Insurance Program Costs

Section

4100:	Insurance Costs	109
4110:	Definition of Insurance.....	109
4120:	Types of Insurance Coverage.....	109
4130:	Definition of Self-Insurance	109
4140:	Insurance Pooling	110
4150:	Self-Insurance Programs.....	110
4160:	Insurance Loans	111
4170:	Comments on Self-Insurance	111
4180:	Definition of Non-Insurance for Grant Reimbursement Purposes	112
 4200:	 Risk Management	 113
4210:	Identifying the Costs of Risk.....	113
4220:	Risk Management and Self-Insurance Program Elements	114
4230:	Reserve Development	115
4240:	Reserves for Catastrophic Losses.....	115
4250:	Reserves for Incurred Losses.....	116
4260:	Funding Insurance Reserves.....	116
4270:	Rate Development	117
4280:	Risk Management Cost Identification Systems.....	118
4285:	Experience vs. Exposure	118
4290:	Risks of Exceeding Maximum Tolerable Self-Insurance Levels	119

4300:	Accounting for Self-Insurance Programs	120
4310:	Reserves and Reserve Accounting	120
4320:	OMB A-87 Insurance Guidelines	120
4400:	Requirements for Grant Reimbursement of Insurance Costs.....	123
4410:	Conditions.....	123
Exhibit 4401:	Self-Insurance Program Data Sheet	127
Exhibit 4402:	Insurance Terminology	129

Section 4100: Insurance Costs

Section 22 of the Insurance Code of the State of California defines insurance as "... a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event."

Section 23 of the same code states, "The person who undertakes to indemnify another by insurance is the insurer, and the person indemnified is the insured."

4110: Definition of Insurance

Industry use of the term "insurance" commonly indicates a method of financing risk by transferring it to a professional risk bearer (insurance company) or to a pool of homogeneous exposures to loss, where "risk" means an uncertainty of loss or injury. In other words, a county or local government is trading a known sum of money (insurance premium) for an unknown sum (the loss paid by the insurance company).

4120: Types of Insurance Coverage

Typically, insurance coverage found in California counties covers various exposures to financial loss. Following are examples.

Tort Liability Losses – Torts are wrongful acts, injuries, or damages, not involving breach of contract, for which a civil action may be brought. Tort losses include general and automobile liability and medical malpractice.

Property Losses – Property losses include loss of use and damage to owned or leased property from such hazards as fire, earthquake, flood, explosions, and theft.

Employee-Related Losses – Employee-related losses include workers' compensation and various employee-benefit coverages such as medical, dental, life, disability, vision, and unemployment compensation.

Protection from such financial loss may be obtained by the purchase of a policy or policies from private insurance companies.

4130: Definition of Self-Insurance

It has been a common practice for the purchasers of insurance to retain a certain amount of the risk through the use of deductibles. In this manner, a county can reduce insurance premiums by agreeing to participate in the payment of losses in some predetermined fashion. In recent years, the insurance premiums for a variety of local government coverages have increased, forcing counties to retain more and more of previously transferred risk through the use of higher deductibles. In many cases, this has led to situations where counties retain all but the greatest amounts of risk, covering these amounts with excess or umbrella-type insurance policies.

This retention of risk has come to be known as self-insurance and today is a common occurrence in the risk management programs of California counties. For the purposes of this handbook, the term self-insurance means the self-retention (non-transfer) of risk in accordance with sound insurance principles, including resource planning and reservation.

4140: Insurance Pooling

Under an insurance pooling arrangement, a county enters into a joint-powers agreement with other local governmental entities, usually with other counties, cities, or special districts in the same geopolitical area or of similar economic size. These arrangements can be for the purposes of commonly insuring all participants for just one category of insurance, such as employee benefits, or for many types of insurance. An example of the latter is the Trindel Insurance Fund, whose members consist of California counties. Trindel provides workers' compensation, general liability, and property damage insurance for its members.

Insurance pooling arrangements operate in much the same manner as risk management works in a county. The pool provides for risk administration, claims adjustment, legal services, loss payments, purchase of excess insurance policies, and all other activities related to the operation of a comprehensive insurance program.

4150: Self-Insurance Programs

Self-insurance has come into widespread use in the risk management programs of California counties. This self-retention of risk has become a viable method of financing potential losses and is especially appropriate for use when losses are predictable. Whenever losses up to certain levels occur so frequently that an average annual loss can be predicted that does not exceed the county's capacity to financially absorb such losses, then it is normally to the county's advantage to self-insure for those losses instead of purchasing insurance.

Self-insurance programs are inseparable from risk management. For example, some of the functions necessary to operate a self-insurance program are identical to those required in risk management. A statement of purpose, program administration, including safety, claims, and legal services coordination, and cost savings analysis are all integral parts of both risk management and self-insurance administration. Other elements that enter into the administration of self-insurance programs are methods of funding and cost distribution to benefiting departments.

The following statement, authored by Gregory Trout and published in Bulletin #3, "Self-Insurance Liability Exposures," March 1977, by the County Supervisor's Association of California, provides an excellent summary of a self-insurance program and its interrelationship with the risk management concept.

A self-insurance program is, in effect, a governmental insurance company and performs the same functions as a commercial insurer. It administers its plan, pays claims, secures legal defense, provides safety inspection services, sets premiums, and achieves a spread of risk, keeping in mind that the principal goal of the self-insurance program is to protect the entity's assets from the risk of loss at a minimum of cost.

4160: Insurance Loans

Loans may be made from insurance funds only to other county funds and under the same criteria imposed for loans from ISFs (see Section 2250, page 55). Such loans may be made only if:

1. The loan is recorded as an amount receivable in the insurance fund's financial records;
2. The loan is repaid with interest computed at the same rate that the insurance fund could have earned had the loan not taken place;
3. The period of the loan does not exceed 36 months;
4. The loan does not impact adversely on the insurance fund's current cash requirements;
5. The loan is included in the measurement of the insurance fund's assets for any actuarial purposes; and
6. The loan agreement includes a clause that permits the insurance fund to demand accelerated repayment of all or any part of the loan if its cash requirements so dictate.

If a loan made by an insurance fund is not fully paid back by the end of the loan period, the loan is regarded as a "bad debt" and requires an immediate rebate from the county general fund to all grant programs.

4170: Comments on Self-Insurance

For public entities, self-insuring as opposed to purchasing insurance can produce several advantages. Because of the recent changes in the attitude concerning the immunity of governmental entities from lawsuits, insurance premiums from private carriers have increased dramatically, arising in part from increased court awards. The entire premium dollar is not used for payment of losses. Expenses for taxes, asset acquisition, and general operations, as well as an increment for profit and contingency, are all built into the premium charge. By self-insuring, local governments can save some of the premium dollars that are not used for loss payment and general operations. Additionally, the amounts previously used to pay premiums can be invested, with the interest earnings used to further reduce the self-insurance program costs.

Another advantage to self-insurance is the improved loss and claims control that can be realized by the implementation of an effective safety and loss prevention program. Under self-insurance programs, the responsibility of losses, and all costs associated with them, can be assigned directly to the departmental managers who can effectively control the risks involved. In this manner, the county managers and personnel take an active role in implementing safety and loss prevention programs, reducing overall program costs to the county.

The process of becoming self-insured presents several obstacles that, although not insurmountable, require the strict attention of those persons responsible for establishing the self-insurance program. Moving from a highly insured position to one of self-insurance should be a calculated, step-by-step process. Consideration should be given to the transfer of responsibility from a decentralized operation to the risk manager. Current

loss reporting systems should be evaluated for efficiency and effectiveness where they exist, and developed where they do not exist. The coordination of information and policy coverage with existing carriers can result in minimal disruption in insurance coverage while producing the potential for cost savings in becoming self-insured.

**4180: Definition of
Non-Insurance for
Grant Reimbursement
Purposes**

A county is considered non-insured if it elects not to purchase insurance or establish a self-insurance program for a particular type of coverage but instead chooses to finance any losses through current or special budget appropriations, bond issues, or other spur-of-the-moment financing. Payments of losses under such a system will not be eligible for grant reimbursement purposes except where specifically provided for in a grant agreement.

Section 4200: Risk Management

Prior to the widespread use of self-insurance, it was necessary for a county to select and acquire the particular combination of insurance policies that offered the greatest protection for the least dollars. Insurance administration, claims adjustment, loss funding and payment, and legal services were left for the insurance company to handle. However, as a county retains more, or all, of the risk in each insurance category, county management must now perform, all or in part, functions previously performed by insurance companies.

A risk management program deals with the evaluation of pure risks (whether insurable or uninsurable) and devises the best methods to treat them. A risk manager has to decide what is the best method of handling each type of risk exposure, whether it be the purchase of insurance or some other technique of risk financing or reduction, while an insurance manager primarily concentrates on managing the insurance policies purchased by the county.

Risk management is a comprehensive managerial challenge covering all aspects of the insurance field. The staff in a risk management department is frequently involved in such tasks as risk evaluation, safety programs, claims adjusting, legal services coordination, property protection programs, insurance policy evaluation, and many other related areas. Because of the many functions involved, it is desirable for counties to centralize their risk management activities.

4210: Identifying the Costs of Risk

The risk management concept dictates that certain categories of expense be considered as the true costs of risk. The categories listed below need to be dealt with by the county when establishing and operating a self-insurance program.

1. **Risk Management Administration** - As detailed in Section 4220, Risk Management and Self-Insurance Program Elements, all administrative functions formerly provided by insurance companies now need to be provided by either county staff and/or contracts with industry specialists.
2. **Loss Prevention Costs** - The risk management concept for self-insurance programs dictates that the county be dedicated to an active program of loss reduction by reducing its exposures to loss. The safety and loss prevention programs effectively implemented by the risk manager and the county staff will lead to reductions in the overall costs of the self-insurance program.
3. **Uninsured Losses** - The level of uninsured losses, including loss expense costs, is that level of risk that the county chooses to self-retain. The chief financial officer and the risk manager generally determine this level, after consideration of how unbudgeted losses would affect the county's present and future financial condition. In general, the county should retain all risks to the maximum tolerable level. Beyond this level, excess insurance needs to be purchased to provide protection in the event of a catastrophic loss.

4. **Insurance Premiums** - The payment of insurance premiums represents a method of funding losses for coverage for which the county chooses not to self-insure.

4220: Risk Management and Self-Insurance Program Elements

Certain elements are necessary for the effective operation of a self-insurance program. The following outline was summarized from interviews with risk managers as well as from articles and publications covering the field of governmental self-insurance. The outline represents that combination of elements necessary for a county to establish and operate a model risk management and self-insurance program.

All self-insurance programs must be operated in conjunction with a comprehensive risk management program established by the county board of supervisors. All functions previously performed by an insurance company should now be provided by either the county staff or through contracts with industry specialists.

A risk management policy statement should be issued, clearly defining to all levels of the county the objectives of the risk management program. This statement must include:

1. The goals of the risk management program;
2. Authority and responsibility of the risk manager;
3. Coordination of the risk management activities;
4. Guidelines on risk management through the use of deductibles or self-insurance;
5. The centralization of the insurance responsibilities; and
6. Support of the risk management philosophy of loss reduction and prevention at all levels of the county.

The county should employ the services of an individual familiar with the aspects of managing risk. If the county does not employ a risk manager, the services of a risk management firm may be engaged to provide assistance in establishing and operating the self-insurance program. Additionally, the county staff should receive formal training in the aspects of managing risk, to provide for the coordination of risk management responsibility.

At a minimum, the county must provide the following administrative functions and bear the associated costs:

1. Risk analysis through actuarial studies and/or loss reporting systems;
2. Claims adjusting (in-house or contract);
3. Claims auditing (in-house or contract);
4. Legal;
5. Loss control programs; and
6. Other administrative functions, such as those that deal with financial support for salaries, supplies, training, space, and other overhead.

As a part of administrative loss control procedures, a county should implement programs to actively reduce the county's exposure to risk from accidental loss, in accordance with its Risk Management Policy Statement. These programs should include:

1. Employee safety programs and emergency procedures;
2. The development of loss control programs to reduce third-party claims; and
3. The development of loss reporting systems to highlight areas for further risk reduction efforts.

The county should determine the maximum tolerable level of losses it can financially afford. Losses beyond this point should be covered through the purchase of excess insurance. Periodically the insurance market should be evaluated to determine if it is more cost effective to purchase insurance below the maximum self-retention level or to self-insure. Excess insurance should be purchased to provide protection above the maximum self-retention level.

4230: Reserve Development

When each self-insurance program is established, the county must develop and monitor reserve accounts for each distinct category of potential loss. If reserve accounts are not established in the county's accounting records for each loss category, supplemental schedules must be maintained that provide this information.

Reserve accounts or accrued expenses should be:

1. Established by actuarial studies or evaluations of loss histories;
2. Discounted for payment in future periods; and
3. Adjusted no less frequently than annually to reflect the most current information.

4240: Reserves for Catastrophic Losses

This reserve represents the county's ability to absorb maximum losses as they occur. Excess insurance is usually purchased in conjunction with this ability to fund losses per occurrence as well as total aggregated losses. This reserve should be established with both a maximum and a minimum level, as defined below.

1. **Maximum Level** - A realistic estimate must be developed of the maximum losses that the county could incur in a fiscal year. When the maximum reserve level is fully cash-funded, charges to users for the reserve should be reduced or suspended until the reserve approaches the minimum level.
2. **Minimum Level** - A realistic estimate of the minimum amount the county needs to cover losses as they occur and still provide financial security to the self-insurance program is also required. When the cash balances fall to the minimum reserve level, reserve charges to users should be re-established or increased to provide additional reserve protection.

4250: Reserves for Incurred Losses

This reserve is directly related to the county's financial obligations for the types of claims listed below. These reserves should be monitored and adjusted no less frequently than annually to ensure that funds for loss payment are being reserved in accordance with the claims adjuster's expectations of loss payments. Reserve requirements are established based upon the following categories.

1. **Claims settled but not paid** - The amount of loss is settled but the claim has not yet been paid.
2. **Claims reported but not settled** - A claim has been filed for a loss but an estimate must be developed concerning the potential loss payment. The estimate can be based on:
 - a. The maximum amount the county could be held liable for upon settlement or award; or
 - b. The realistic amount the county will be required to pay upon settlement or award.
3. **Reserve for incurred but not reported (IBNR) losses** - GASB-10 defines IBNR claims as "claims for insured events that have occurred but have not yet been reported to the governmental entity, public entity risk pool, or reinsurer." IBNR claims include:
 - a. Known loss events expected to be presented later as claims;
 - b. Unknown loss events expected to become claims; and
 - c. Expected future developments on claims already reported.

Reports should be prepared at least annually for each self-insurance program. These reports should include a reconciliation of reserve levels versus loss payments.

4260: Funding Insurance Reserves

Insurance reserves should be funded with cash and/or investments to provide for payment for losses. When funding for reserves is directly charged or allocated to grant programs, the following requirements are mandatory.

1. All reserves must be segregated in restricted accounts or accounted for separately and used exclusively for the purposes for which they were intended. If the money accumulated in a self-insurance reserve is utilized for other purposes, a credit in the same amount as the "reserve reduction" must be applied to all departments participating in the self-insurance program. If the entire reserve reduction occurs in one year, all of the credit must be applied in one year or, in unusual circumstances, amortized over a period negotiated with the State Controller's Office.
2. All reserves should be invested in interest-earning accounts with interest accruing to the self-insurance program, as mandated by Section 25263 of the Government Code of the State of California. Interest earnings can be used for payment of administrative costs and loss payments, and they should generate rate reductions in charges to users after the maximum reserve levels have been reached.

4270: Rate Development

Counties should have the following points foremost in mind when developing rates to charge the participants in the self-insurance program.

1. Reserves should be funded through rate charges to users, accumulating over a period of time.
2. A “premium” should be developed for each self-insurance category (i.e., liability, workers’ compensation, unemployment, etc.) based on:
 - a. Risk management administrative costs;
 - b. The cost of excess insurance premiums; and
 - c. The amounts required to maintain each category of reserve at a safe level. Establishing this requires monitoring the actual losses from claims payments and claim accruals and monitoring payments from and contributions and/or adjustments to each reserve by, at a minimum, worksheet analysis.

Rates should be developed to charge the user departments for their share of the “premium.” Rates should reflect the following factors.

1. A factor for loss experience (sometimes referred to as actual loss) - Provision should be made to charge some portion of self-insurance costs on the basis of actual loss experience. Loss histories should be developed and maintained by the risk manager and adjusted annually. In order to maintain a “rolling average” each year, losses for the earliest year should be eliminated while losses from the most recent year are added. Five years is the minimum loss history period that should be used for this moving average, and a maximum period of seven to ten years is recommended. From 70% to 80% of each insurance premium should be allocated based on experience. Losses charged to departments and/or funds may be limited to a maximum amount (capped) as long as the losses are treated uniformly and consistently. (See the following section for further discussion.)
2. A factor for loss exposure (sometimes referred to as risk) - Provision should be made to charge 20% to 30% of each type of self-insurance cost on the basis of the county's exposure to potential losses.
3. The exposure rate should be applied to a base that best measures the exposure; following are examples.
 - a. For workers' compensation and unemployment, the salaries of the individuals covered usually serves as a readily identifiable base. Provision should be made, however, to include those volunteers and other individuals included under this coverage who do not receive payment for their services.
 - b. Benefit programs generally relate directly to the number of individuals covered.
 - c. Liability coverage is a complex issue. Consideration must be given to departmental activity in relation to the county population, number of personnel employed, budget size, total payroll, square footage of occupied space or grounds area, or

other reasonable exposure measures that contribute to the amount of liability risk related to a department. The number of employees alone is not an acceptable allocation base for the distribution of general liability insurance; the number of employees can be used in conjunction with other data to distribute these costs.

The rates used to charge the costs of each self-insurance program should be reviewed at least annually and adjusted when needed to reflect changes in the cost of providing insurance.

4280: Risk Management Cost Identification Systems

After the total costs of the risk management program have been accumulated, some means of identifying these costs to the participating funds, departments, and programs must be developed. The following three rules should be applied.

1. **Reasonableness** - The cost identification system should be based on common sense and be defended with a rational, logical argument. The allocation base used must have a causal relationship between the cost of coverage and the benefit received.
2. **Consistency** - Whatever method of cost identification is chosen, it should be consistently applied, not only during the year but between fiscal years as well.
3. **Experience vs. Exposure** - Assigning the greater portion of insurance costs to the departments that have actually sustained losses ensures that these losses are matched to insurance costs. This practice encourages the application of departmental loss management practices and facilitates the identification of operations and procedures that should be addressed by the risk manager. This distribution of insurance cost by experience alone, however, does not take into consideration that, although a department may not have incurred a loss, it still participated in the exposure to potential losses. This is especially true for coverage with the same nature as general liability, where all county departments have the potential to incur losses. Thus, the exposure factor plays an important role in the overall development of an insurance cost identification system.

4285: Experience vs. Exposure

When a county is developing its cost identification, allocation, and billing procedures for insurance purposes, reliance should be placed on past experience to develop the division between exposure and experience, as described above. If a county's loss experience is insufficient, it should contract with one of the insurance-consulting firms specializing in this area. The consulting firm could set up a self-insurance operation that includes the means of developing charges to the participating departments. Initially, the division between the experience and exposure factors could be arbitrarily determined. As the county's loss history is developed over a period of time, the emphasis on historical losses could shift the weighting of this division towards the experience factor.

If possible, a county should initially establish the experience/exposure division at 50/50. After five years of loss history, a 70/30 division favoring experience may be determined as being more realistic. After ten years of loss history, approximately 80% of the annual premium charge would be based on the average loss history, with 20% of the annual premium distributed on the exposure to potential losses.

Because each county's loss experience for its various insurance coverages is unique, the State Controller does not attempt to dictate an absolute ratio that must be used in dividing total insurance program costs between exposure coverage and loss experience. However, due consideration must be given to the exposure factor. Once the ratio between experience and exposure is established, any changes in these percentages must be made gradually and must be based upon analysis of information provided by the loss histories.

**4290: Risks of
Exceeding Maximum
Tolerable Self-
Insurance Levels**

A local government may exceed the maximum tolerable risk retention level, beyond which uninsured losses will impair its financial stability. This possibility is not purely hypothetical since actual situations of this nature have already occurred across the United States. It is essential that all losses anticipated as being retained be within the financial capacity of the entity, given its various capital and operating requirements. Additionally, layers of insurance above the self-retained levels should be provided so that the risk of loss greater than the entity is capable of absorbing (catastrophic) is transferred to a carrier outside of the entity. The failure to have reserves for loss contingencies or at least the ability to finance such losses from current appropriations or by borrowing, and the failure to obtain coverage above retained self-insured levels, effectively results in an under-funded or unfunded insurance program.

Section 4300: Accounting for Self-Insurance Programs

Once a county has determined that the use of a self-insurance program will be cost effective, a method must be chosen to account for the program. Before the use of self-insurance, most insurance premiums were paid out of either the general fund or a specific fund for which the insurance coverage was purchased. Since self-insurance may cover more than one fund, consideration must be given not only to accounting for all of the costs of each self-insurance program but also to identifying the costs to the various funds and departments included in the program's coverage.

The State Controller's *Accounting Standards and Procedures for Counties Manual*, Risk Management chapter, addresses the subject of accounting for self-insurance programs. This chapter, recommends the use of an internal service fund to account for the total cost of any self-insurance program, whether the county is wholly or partially self-insured.

4310: Reserves and Reserve Accounting

Section 4260, page 116, of this handbook requires catastrophic reserves, incurred loss reserves, and IBNR reserves to be funded with cash and/or investments to provide for the payment of losses. The use of an internal service fund by itself denotes that the moneys collected in the fund have been designated for self-insurance purposes. Net assets that are accumulated in accordance with a current (within the previous two years) study prepared by an independent actuarial consultant should be reported as restricted. From an accounting standpoint, reserves can be reflected within the equity section of the balance sheet by "designating" or "restricting" net assets, whichever is appropriate to the circumstances. This is particularly applicable to the funds that are set aside for catastrophic protection, since such funds may not be routinely accounted for on an accrual basis. Conversely, if an annual accrual is established for either incurred loss expense or incurred but not reported loss expense, it is not necessary to restrict a corresponding portion of net assets. The State Controller's Office will review county insurance funds in order to determine if accrued liabilities and/or restricted net assets are within funding levels recommended by independent actuaries. Insurance funds that are funded at less than actuarially recommended levels will be required to take positive actions to increase their reserves. Insurance funds whose reserves exceed actuarially derived levels will be required to reduce these levels by adjusting their rates or by proportionally refunding their excess reserves to all of the entities that have been assessed insurance charges by the fund. The conditions that a county must satisfy if their grant programs are to participate in county insurance programs are summarized in Section 4410, page 123.

4320: OMB A-87 Insurance Guidelines

The guidelines dealing with insurance are contained in OMB A-87, Attachment B, Section 25, Insurance and Indemnification. Subparagraph a. of this section states, "Costs of insurance required or approved and maintained, pursuant to the Federal award, are allowable." Subparagraph b. adds, "Costs of other insurance in connection with the general conduct of activities are allowable." In essence, the cost of insurance specifically required by a grant agreement is allowable. Additionally, the costs of insurance purchased in connection with the conduct of general activities undertaken by the county are allowable if the types and extent and cost of

this insurance follows general county policy and sound business practices. The reimbursement of insurance costs includes reimbursement for nominal deductible insurance coverage and minor losses not covered by insurance, such as spoilage, breakage and disappearance of small hand tools, that may occur in the ordinary course of operations.

OMB A-87, Attachment B, Section 25.d., allows contributions to a reserve for certain self-insurance programs, including workers' compensation, unemployment compensation, and severance pay. The reserve contributions are allowable, subject to the following provisions.

1. The type of coverage and the extent of coverage, and the rates and premiums would have been allowed had the insurance (including reinsurance) been purchased to cover the risks. However, provision for known or reasonably estimated self-insurance liabilities, which do not become payable for more than one year after the provision is made, shall not exceed the discounted present value of the liability. The rate used for discounting the liability must be determined by giving consideration to such factors as the government unit's settlement rate for those liabilities and its investment rate of return.
2. Earnings or investment income on reserves must be credited to those reserves.
3. Contributions to reserves must be based on sound actuarial principles using historical experience and reasonable assumptions. Reserve levels must be analyzed and updated at least biennially for each major risk being insured, taking into account any reinsurance, coinsurance, etc. Reserve levels related to employee related coverages will normally be limited to the value of claims
 - a. Submitted and adjudicated but not paid,
 - b. Submitted and not adjudicated, and
 - c. Incurred but not submitted.

Reserve levels in excess of the amounts based on the above must be identified and justified in the cost allocation plan or indirect cost rate proposal.

4. Accounting records, actuarial studies, and cost allocations (or billings) must recognize any significant differences due to types of insured risk and losses generated by the various insured activities or agencies of the government unit. If individual departments or agencies of the governmental unit experience significantly different levels of claims for a particular risk, those differences are to be recognized by the use of separate allocations or by other techniques resulting in an equitable allocation.
5. Whenever funds are transferred from a self-insurance reserve to other accounts (e.g., general fund) refunds shall be made to the federal government for its share of funds transferred, including earned or imputed interest from the date of transfer.

In summary, if a type and amount of coverage would be allowed by purchasing insurance, then a self-insurance program offering the same type and extent of coverage is also allowable. Additionally, if rates could have been computed using total insurance costs as represented by the premium, as in worker's compensation coverage, for example, then rates can also be computed to assess county funds and departments for self-insurance program costs. Self-insurance rates are not limited to the premiums and rates that would have been used had insurance been purchased.

Except for the above, if actual losses could have been covered by the purchase of insurance or by a self-insurance program but were not, these actual losses are to be considered unallowable costs for grant reimbursement purposes. However, actual claims paid to or on behalf of employees or former employees for workers' compensation, unemployment compensation, severance pay, and similar employee benefits (such as post-retirement health benefits permitted by OMB A-87, Attachment B, Section 11.f) are allowable in the year of benefit, provided:

1. The governmental unit follows a consistent costing policy, and
2. Claim costs are allocated as a general administrative expense to all applicable activities of the governmental unit.

Section 4400: Requirements for Grant Reimbursement of Insurance Costs

This section summarizes the conditions under which grant programs may participate in the reimbursement of purchased insurance or self-insurance program costs.

Where the county has chosen to purchase a particular coverage from an outside carrier rather than to self-insure, the cost of those premiums is allowable for grant reimbursement purposes when distributed to the benefiting departments.

4410: Conditions

When a county chooses to utilize a self-insurance program for a particular type of coverage, it must meet the following conditions.

1. All county self-insurance programs must be established and operated in conjunction with the guidelines in Sections 4100 through 4400. Non-compliance with one or two points in these guidelines will generally result in suggestions for improvements in future years. Material non-compliance will be determined only by the State Controller's Office. Material non-compliance can result in the disallowance of self-insurance costs charged to grant programs.
2. If a county chooses either a) not to purchase insurance, or b) not to establish a self-insurance program but to finance any losses through special budget appropriations, bond issues, or other spur-of-the-moment public financing, this is considered a system of "no insurance." Payment of losses under such a system are not eligible for grant reimbursement purposes, unless specifically provided for in a grant agreement.
3. Cost participation through grant reimbursements is allowed for workers' compensation and unemployment compensation insurance programs where the county follows a consistent practice of expensing normal losses directly to the departments in the year of occurrence. Because the intent is not to inequitably burden any one grant program, grantee departments must spread these actual losses equitably among their programs, and the county should still provide protection against a potential catastrophic loss from being charged solely against one department's budget.
4. All self-insurance programs in use by the county must be managed in accordance with sound insurance principles and practices, including adequate resource planning and reservation. This means the establishment of cash reserves adequate to cover the self-retained loss anticipated by the county. These cash reserves must be treated as "inviolable" and not used for any purpose other than for which they were intended. If the money accumulated in a self-insurance reserve is used for other purposes, a credit in the same amount as the "reserve reduction" must be applied to all departments participating in the self-insurance program, or a cash refund may be made.

5. According to the County Budget Act, Government Code Section 29000, et. seq., reserves will be established by the county board of supervisors. Therefore, all self-insurance programs utilizing reserves must have such reserves established by board-of-supervisor action. The level of reserves should be established in accordance with sound insurance principles and practices, including actuarial studies or comprehensive evaluation of past loss experience, and the level must be consistent with the objectives of the self-insurance coverage.
6. If reserves have been established through charges to departments, the moneys collected must be invested in interest-earning activities. Where reserves were established by transfer from the general fund and have not been charged directly to users or allocated through the cost plan, the moneys should be invested in interest-earning activities to achieve an overall cost reduction of the self-insurance program.
7. All costs of the self-insurance program, including loss payments, administrative expenses, and premiums for excess insurance coverage, should be paid out of an internal service fund as recommended by the State Controller. This fund can be financed through charges to either the benefiting departments or participating funds. If the latter charge-out system is chosen, further allocations should identify costs to the departments within each fund.
8. If a county chooses not to implement internal service fund accounting for its self-insurance programs, the self-insurance reserves described in Section 4300 of this handbook must be accounted for in trust fund(s) to be eligible for grant reimbursement. Contributions from each participating fund to the trust fund will be invested and subsequently used for all loss payments under the program. Only these contributions can be allocated to all departments within each participating fund. Actual loss payments made out of the trust fund will not be eligible for reimbursement. If previously set forth in the county's self-insurance resolution, any risk management expenses or excess insurance premiums paid out of the general fund can also be allocated to the benefiting departments.
9. Grant reimbursement participation in self-insurance program costs will be allowed up to the maximum reserve level established plus the attendant administrative expenses of the insurance program. Large increases in contributions to a self-insurance reserve should be discussed with the State Controller's Office to determine if allocation over a period of years is necessary and to ensure proper treatment in the computation and use of carry-forward and estimated costs.
10. Each type of insurance should be accounted for separately, but separate funds are not required. The State Controller's Office recommends, and counties are encouraged to utilize, an internal service fund in accounting for self-insurance programs.
11. A comprehensive description of each self-insurance program must be included in the cost plan. The following information should be submitted or updated annually by the county risk manager:
 - a. A description of the types of coverage for which the county is self-insured;

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- b. The amount of current self-insured retention for each type of coverage, and whether or not excess insurance coverage is purchased;
 - c. The method used to set the maximum reserve level and the current funding level of each self-insurance program reserve;
 - d. The method by which insurance costs are distributed to insurance pool participants, including percentages assigned to experience and to exposure, the number of years used to determine loss experience, and the factor(s) used to assess loss exposure.
 - e. The method of accounting for each self-insurance coverage (trust fund reserve, internal service fund); and
 - f. The most recent financial statements of the trust or internal service fund. These must include: a listing of all transfers into and out of the fund; a copy of the current actuarial report; and a description of the method of cost identification and allocation to participating departments for each type of insurance. New actuarial studies for each major risk being insured must be procured no less frequently than once every two years.

Completion of Exhibit 4401, page 127, for each self-insured program will provide the necessary information. An alternate format may be used, provided the same information is submitted.

Exhibit 4401**SELF-INSURANCE PROGRAM DATA SHEET ***

COUNTY OF _____

_____ INSURANCE

FISCAL YEAR _____

Date Established: _____

Current Maximum Self-Retained Risk:

Per Occurrence: \$ _____

Aggregate: \$ _____

Current Reserve Level:

Catastrophic: Maximum Authorized: Currently Funded:

IBNR: \$ _____ Catastrophic: \$ _____

IBNR: \$ _____ IBNR: \$ _____

Purchased Insurance: Excess Umbrella Coverage:

First Layer \$ _____ to \$ _____

Second Layer \$ _____ to \$ _____

Description of Coverage: _____

Description of Cost Distribution Methodology: _____

Method of Accounting:

_____ Cash

_____ Modified Accrual

_____ Full Accrual

Fund Type:

_____ Internal Service *

_____ Trust *

_____ General

_____ Other (Describe fully)

* ATTACH COPIES OF MOST RECENT FINANCIAL STATEMENTS AND ACTUARIAL REPORTS.

Exhibit 4402

Insurance Terminology

Aggregate (Stop-Loss)	Excess coverage with a “deductible” applying to losses on an annual, not on a per-occurrence, basis.
Catastrophic Reserve	A portion of the reserve fund used to protect the county from a loss of an unexpectedly large amount. Sometimes improperly called a contingency reserve or surplus reserve.
Cost/Benefit Analysis	An analysis of possible alternatives by the differences in their costs and the expected benefits to be received.
Deductible	Amount the insured agrees to pay on each loss before the insurance carrier begins contributing towards the loss.
Excess Insurance	Coverage purchased to pay catastrophic or “shock losses” above the normal level of losses.
Incurred but not Reported (IBNR) Losses	Losses arising from incidents where a claim has not yet been reported. Insurance companies are required to make an estimate of their IBNR losses.
Incurred Loss	The potential payment that may be required to pay damages arising from an event that has already occurred.
Incurred Loss - Reserving	Establishing, through the budget process, sufficient funds to meet both paid and outstanding losses likely to occur during a policy year.
Layer	A level of insurance limits. A primary layer may be insurance limits of \$500,000 per person and \$500,000 per occurrence; an excess layer may be the next \$500,000 per person above that.
Maximum Reserve Level	A predetermined maximum amount that a reserve is allowed to reach. Once this level is reached, further contributions are not made.
Pooling	The sharing of risk by several entities exposed to the same hazards.
Retention	The amount of loss exposure retained by an entity. Financially, this is similar to an insurance deductible.
Risk	Exposure to loss.
Risk Management	The evaluation of exposure to loss, and the determination and implementation of the most economical and effective way to handle that exposure.
Self Insurance	Handling losses through the use of a self-funded plan to assume the risk of loss. A self-insurance plan may have all or some of the characteristics of an insurance company: personnel to administer the program, loss prevention, etc.

Handbook Revision Request

Handbook of Cost Plan Procedures for California Counties

Date: _____

Section Number: _____

Section Title: _____

Please check the appropriate line(s):

- _____ A. Typing, punctuation, spelling, or other error in composition or construction
- Circle or highlight the error.
- _____ B. Text changes - Attach a copy of the handbook pages to be changed and a legible copy of your recommended changes.
- _____ C. Interpretation of content - Underscore the content area in question and attach a copy of this form.
- _____ D. Miscellaneous comments and/or suggestions - Attach comments, questions, and/or recommendations.

AGENCY:

NAME: _____

TITLE: _____

PHONE NUMBER: _____

Send requests to:

Cost Plans and Local Apportionments Section
Division of Accounting and Reporting
State Controller's Office
P.O. Box 942850
Sacramento, CA 94250

